IRSG

INTERNATIONAL
REGULATORY
STRATEGY GROUP

FINANCIAL SERVICES PRIORITIES FOR THE UK'S G7 PRESIDENCY

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CITY OF LONDON

TheCityUK

INTRODUCTION

In January 2021, the UK took over the presidency of the G7 from the USA at a pivotal time – when the incoming U.S. administration is re-engaging with multilateral bodies. The UK government has the opportunity of demonstrating leadership on the global stage post-Brexit, working collaboratively with G7 and G20 partners and addressing the economic challenges posed by the pandemic. With the UK co-hosting COP26 with Italy, the G7 presidency provides a unique opportunity to achieve a high-level consensus across a number of key agendas.

Pandemic recovery, climate and the digital agenda all feature strongly among the UK's priorities for its G7 presidency. To that end, this report seeks to contribute the perspective of the UK financial and related professional services (FRPS) sector to the UK's agenda for the G7. The International Regulatory Strategy Group (IRSG) identified key FRPS priority areas for the G7 in January. This paper sets out detailed thinking on how the UK can achieve significant progress in the above areas.

Regulatory *fragmentation* remains a significant challenge. The UK should work towards ensuring continued regulatory coherence and convergence in order to avoid hampering the recovery by locking capital behind national borders. Furthermore, there are advantages of sharing good practice and ideas on recapitalisation, addressing corporate indebtedness, to aid pandemic recovery. It will be important to ensure that pandemic recovery is a green, sustainable and equitable recovery, and one that is consumer-centric and takes into account consumer financial resilience.

As global standard setters recalibrate their work programmes to account for the effects of the pandemic, the industry calls for the same global regulatory co-operation that was witnessed in the aftermath of the 2008 crisis and is advocating for clear guidance to address the emerging challenges posed by the pandemic.

SUMMARY OF RECOMMENDATIONS

In summary, the IRSG believes the UK's G7 presidency can tackle the most pressing challenges for the global economy by focussing on the following four areas:

1. GLOBAL REGULATORY COHERENCE FOR PANDEMIC RECOVERY

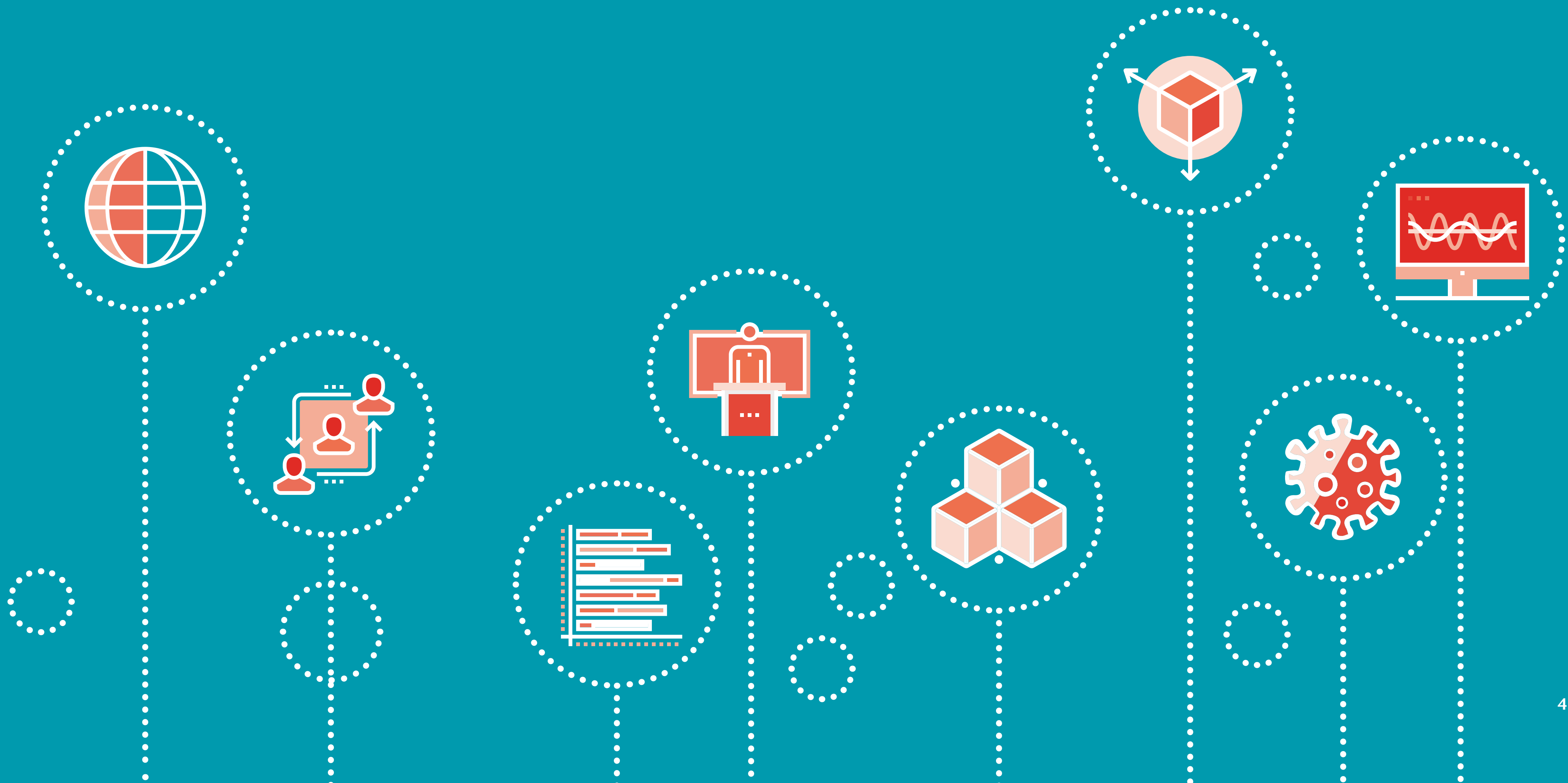
2. LEADERSHIP ON SUSTAINABLE FINANCE AHEAD OF COP26

3. DIGITAL POLICY CONTINUITY, INCLUDING ON DIGITAL TAXATION

4. ALIGNMENT WITH G20 GLOBAL POLICY PRIORITIES

> **"Pandemic recovery, climate and the digital agenda all feature strongly among the UK's priorities for its G7 presidency."**

1. GLOBAL REGULATORY COHERENCE FOR PANDEMIC RECOVERY, RECAPITALISATION AND RESOLUTION



Unprecedented economic shock

Last year, the global economy underwent the most significant economic shock since the 2008 financial crisis. In the UK, the effects of the COVID-19 virus itself, the imposition of public health restrictions and voluntary social distancing to contain its spread, meant that among the G7 countries, the UK economy experienced the largest contraction in volume GDP over the first six months of 2020, with a 8.6% shortfall in volume GDP as of the end of Quarter 3 2020 relative to its pre-COVID level.[1]

As economies around the world adopted lockdown measures to combat the health crisis, an immediate global liquidity crisis was avoided owing to global markets functioning well and governments rallying to provide support to businesses and providing temporary debt service relief to developing countries.

Stressed liquidity conditions did not translate into a banking crisis owing to the measures put in place following the 2008 financial crisis – specifically, the too-big-to-fail systemic reforms established after the G20 London summit in April 2009, implementing institutional mechanisms to ensure sufficient liquidity in times of global financial stress. That said, a holistic assessment of how the financial system performed during this stress event is necessary, and later this year the FSB will report on lessons learned and whether further reforms are needed to reinforce its resilience.

Emerging issues from the pandemic

The unprecedented economic shock from the pandemic has once again underlined the importance of global cooperation to protect against the effects of this crisis and its emerging challenges. For instance, reputational issues for the financial services sector remain as **online financial scams** are on the rise, as is online gambling. UK FRPS trade associations, such as UK Finance have shared how the pandemic has been exploited by crime. In the UK, £207.8 million was lost to Authorised Push Payment (APP) fraud, in line with the same period last year, and the trade body is calling for legislation to ensure greater consumer protection.[2] Importantly, the issue of online financial scams has underlined the need for local cooperation between regulators due to the role of platform businesses (e.g. social media). In the UK, the Digital Regulation Forum, which the Financial Conduct Authority formally joined in April, is a welcome move. Attention could also be turned towards looking at obligations on those hosting online financial services advertisements to ensure that these are being placed by genuine regulated entities.

In addition, there are questions of whether, in light of the pandemic, enhancements could be made both to the too big to fail (TBTF) reforms for systematically important banks (SIBs) as well as to the regulatory framework for how the non-bank sector has performed in light of the pandemic, which will be a focus for the FSB's work this year. According to analysis by the FSB, the TBTF reforms could be developed further in the areas of total loss absorbing capacity implementation and transparency of resolution funding mechanisms;

1 https://www.ons.gov.uk/economy/grossdomesticproductgdp/articles/internationalcomparisonsofgdpduringthecoronaviruscovid19pandemic/2021-02-01

2 https://www.ukfinance.org.uk/press/press-releases/criminals-exploit-covid-19-fraud-moves-increasingly-online

it also found that while the post-GFC growth in market share of non-bank financial institutions may have enhanced the stability of the financial system through the diversification of funding sources, there are vulnerabilities, such as in short-term credit markets, which require to be addressed. These are areas of focus for the FSB's work this year[3].

Much has been said about a V-shaped recovery from the pandemic slump and avoiding a W-shaped double-dip-recession. In order to achieve this, it will be imperative to address emerging industry macroeconomic and fiscal concerns over:

- how governments **unwind quantitative** easing measures,
- how they deal with the currently historically all-time **low interest rate** environment,
- **debt sustainability**, the role of private vs sovereign creditors,
- how to avoid **liquidity issues** turning into solvency issues as lockdown measures continue for an extended period of time and ultimately -
- how to build back better while keeping in mind the **climate** agenda and beyond to account for business model viability and wind-down support measures needed.

It will be important to strike the right balance on the role of private vs sovereign creditors for emerging market debt relief post-pandemic. Currently, **private creditors** are not incentivised to participate and a viable incentive mechanism should be put in place to drive private creditor participation. The UK G7 presidency has a role to play, driving global consensus with stakeholders, including through work with Multilateral Development Banks (**MDB**s).

As world economies shift gear towards pandemic recovery, it will be important for the UK and its G7 partners to work together to address the above issues and thus, support global recovery. Joint coordinated action and global regulatory coherence is needed to minimise potential future fragmentation and protectionist policies in the wake of the pandemic. It underlines the importance, now more than ever, of promoting regulatory coherence. It is important that the pandemic recovery is a sustainable, equitable and citizen-centric recovery.

"Joint coordinated action and global regulatory coherence is needed to minimise potential future fragmentation and protectionist policies in the wake of the pandemic."

3 https://www.fsb.org/work-of-the-fsb/financial-innovation-and-structural-change/non-bank-financial-intermediation/

Recovery and recapitalisation

In relation to COVID economic recovery, there are a number of areas where the UK can show global leadership via its G7 presidency. Global health is certainly an immediate priority and the financial services industry pledges its support of the vaccine rollout globally. Beyond that, leadership is required on the **recapitalisation** of the corporate sector, policies to mitigate the effect of **zombie indebtedness**, and new ways to attract growth equity capital to SMEs through regulatory reform. To that end, we welcome the OECD report[4] on *Fostering Economic Resilience in a World of Open and Integrated Markets*, which offers a broad range of recommendations to the G7 on building economic resilience, serving as a roadmap to the G7 presidency's Economic Resilience Panel[5].

TheCityUK has done extensive work on Covid-19 recapitalisation and the role of the FRPS industry in post-COVID recovery.[6] Subsequently, the Group of Thirty[7] has set out its recommendations for the recapitalisation of the corporate sector, focusing on longevity of reforms and consultation with the private sector. Recently, a report by the Association for Financial Markets in Europe (AFME) and PwC warned that an equity shortfall of up to €600bn threatens Europe's economic recovery (potentially leading to widespread and imminent business defaults and job losses as COVID-19 state support measures are gradually reduced), despite the significant public support measures and private capital made available across Europe to support economies during the pandemic.[8]

The report revealed that 10% of all European companies have cash reserves to only last six months. AFME has called on the European Commission and Member States to introduce measures to bolster Europe's equity and hybrid markets and expand funding avenues for businesses, further enabling Europe's economic recovery.[9] The G7 should review existing thought leadership on recapitalisation as it considers its approach.

The IRSG has underlined the need for coordination on a global level in order to support pandemic recovery[10]. The UK government should leverage its G7 presidency to build a consensus on measures to boost the recovery of the corporate sector among leaders across the G7 and beyond. In doing so, we urge the government to build on the work currently being led by the Bank of England in its review of productive finance.

The concerns about the recapitalisation of a highly leveraged corporate sector are compounded by the risks of creating zombie firms. Zombie indebtedness has been compounded by the pandemic. The UK can demonstrate leadership by developing proactive policy solutions to help reduce corporate leverage post-pandemic. To that end, we note the UK government's work on recapitalisation with HM Treasury, the Bank of England and the Financial Conduct Authority's set up of a Working Group to facilitate investment in productive finance for recapitalisation.[11]

4 https://www.oecd.org/newsroom/oecd-reports-to-g7-on-need-to-strengthen-economic-resilience-against-crises.htm
5 https://www.g7uk.org/economic-resilience-panel/
6 https://www.thecityuk.com/home/covid-19-update/recapitalisation/
7 https://group30.org/images/uploads/publications/G30_Reviving_and_Restructuring_the_Corporate_Sector_Post_Covid.pdf
8 https://www.afme.eu/news/press-releases/AFME-Equity-and-hybrid-markets-hold-solution-to-European-COVID-19-corporate-recapitalisation

9 Measures proposed include: the development of a common, standardised COVID-19 recapitalisation instrument, deployed in conjunction with a corporate education programme; the scale up of existing recapitalisation schemes such as the European Guarantee Fund and replicate existing initiatives at member state level; the development of public-private forums to develop new schemes and run corporate education programmes; the development of an EU-wide public-private investment fund; as well as the introduction of investor incentives (i.e. time-limited capital gains tax exemptions and temporary adjustments to regulatory capital and solvency requirements).
10 https://www.irsg.co.uk/resources-and-commentary/irsg-report-global-solutions-to-global-problems-promoting-regulatory-coherence-in-financial-services-for-pandemic-recovery/
11 https://www.bankofengland.co.uk/financial-stability/working-group-on-productive-finance

Policymakers can deploy a range of strategies to proactively avoid a future insolvency crisis and find ways to manage this debt, by encouraging sustainable investment in productive new enterprises, and incentivising the creation of new, viable jobs, while considering loans for strategically important enterprises, and promoting reskilling incentives in case of redundancy.

To avoid the above risks undermining the recovery, government support across the G7 through targeted grants, loans, guarantees and investments could play a key role in delivering a recovery which is fair, efficient and fast. While equity markets are not easily comparable across G7 markets, we recommend developing a menu of options through globally co-ordinated, expert analysis, potentially led by the Financial Stability Board (FSB), which could help jurisdictions choose solutions that meet their particular needs. To that end, we welcome the FSB membership's adopted measures to ensure that the financial system is able to respond to the pandemic, based on the FSB's five principles on lending and credit support; funding and liquidity support; market functioning; operational continuity and authority business continuity measures, which the UK and the G20 community has signed up to[12].

G7 RECOMMENDATIONS:

- **G7 to aid the set-up of public-private forums to develop new schemes and run corporate education programmes, building on existing thought leadership on recapitalisation.**
- **G7 to ask the Financial Stability Board to convene a forum of its membership to share best practice and draw up a plan on securing corporate recapitalisation at scale, based on productive finance principles, including a menu of options for addressing zombie debt risks arising from the pandemic.**

"Policymakers can deploy a range of strategies to proactively avoid a future insolvency crisis and find ways to manage this debt, by encouraging sustainable investment in productive new enterprises."

12 https://www.fsb.org/work-of-the-fsb/covid-19-maintaining-financial-stability/covid-19-policy-responses/

Protectionism and regulatory fragmentation

There has been an emerging trend in policy and regulatory **protectionism** in response to the pandemic, particularly in global trade. In September 2020, ICAEW noted that as governments feel the pressure to implement protectionist policies and measures – including tariffs, quotas and subsidies – as a way of 'saving' domestic jobs and enterprises, an acceleration towards protectionist trade policies will follow.[13] In October 2020 the World Trade Organization forecast a 9.2% decline in the volume of world merchandise trade for 2020, followed by a 7.2% rise in 2021.[14]

In fact, in its policy paper 'Global Britain, local jobs', the Department for International Trade concurred that protectionist sentiment has been on the rise for over a decade, but has intensified in recent years – fuelled by the COVID crisis, sharing that since the G20 Summit in 2018, G20 governments have imposed **subsidies** four times more often than between 2014 and 2017 and that the pandemic has further prompted a surge in **import and export restrictions**.[15]

13 https://www.icaew.com/insights/viewpoints-on-the-news/2020/sep-2020/trade-will-covid19-drive-further-protectionism
14 https://www.wto.org/english/news_e/pres20_e/pr862_e.htm
15 https://www.gov.uk/government/publications/board-of-trade-report-global-britain-local-jobs/global-britain-local-jobs-html-version

In November 2020, the United Nations Conference on Trade and Development (UNCTAD) considered the impact of the pandemic on trade and development and noted the shift towards regionalism and increased protectionism.[16] Mukhisa Kituyi, Secretary-General of UNCTAD noted in October 2020 that inward looking policies and trade protectionism will also increase imbalances in the recovery process, adding to the risk that the pandemic will exacerbate existing inequalities, creating the real possibility that the least developed countries (LDCs) will fall further behind.

Kituyi urged that in order to avoid a surge in protectionist measures, governments must monitor how responses to COVID-19 affect trading partners. They must ensure that any such measures are targeted and temporary, and duly address the interests of affected countries, particularly LDCs. Ultimately, keeping exports to developing countries flowing without unwarranted impediments will be crucial to a broad-based recovery.[17]

16 https://unctad.org/system/files/official-document/osg2020d1_en.pdf
17 https://unctad.org/news/new-take-trade

Restricting investments is another measure that can impede global recovery. A number of countries issued plans to apply additional scrutiny and screening to certain investments during the pandemic. Measures were put in place in Canada with the Investment Canada Act, the European Union with new guidelines on health and medical research investments.[18] Differing countries' investment screening processes vary in severity: the UK government has recently proposed a welcome relaxation of the acquisition thresholds in the UK National Security and Investment Bill, currently before Parliament.

As governments turn inward and regulators become more risk averse, this has led to policy and regulatory **localisation**, such as requiring localised capital and liquidity fragmentation (for instance, as in the case of CCPs in the EU). Disruption and subsequent localisation of supply chains and supplier choices and immigration restrictions, has been a significant trend during the pandemic, affecting banking, asset management and related professional services alike. Challenges have also been posed for global firms' operations by extraterritorial provisions in relation to intra-group outsourcing.

Data localisation policies have had a particularly significant effect with restrictions or practices affecting cross-border data flows, digital products, Internet-enabled services and other restrictive technology requirements being pursued by several countries. In December 2020, the International Regulatory Strategy Group (IRSG), in collaboration with DAC Beachcroft LLP, launched a report on '*How the trend towards data localisation is impacting the financial services sector*'. The report argues that the financial services sector is witnessing increasingly protectionist behaviours across the world in the form of data localisation. Due to various concerns, governments have sought to protect the data of their citizens by implementing restrictions on its transfer. This is leading to changes in the approach to data protection and other related regulation, with businesses no longer able to share data across borders on the same basis as they have done in the past.[19]

The report includes recommendations on how alternative measures could potentially better address the concerns of both national governments and regulators that have resulted in data localisation, which we argue should be adopted by the G7. The recommendations are as follows: a) a principles-based approach to data protection; b) regulatory oversight concerns should be addressed by rules on access rather than location; c) operational resilience should focus on the quality of the outsourcing solution, not its location; d) increased co-operation at an international level; and e) use of international trade agreements to remove barriers.

To address these challenges, with the G7 presidency, the UK should take action to uphold the global trading system and help strengthen the role of the World Trade Organisation, where the WTO Joint Statement Initiative (JSI) on E-Commerce can be useful. One of its immediate priorities should be addressing data localisation, guided by the recommendations set out in the IRSG report.

18 https://www.brinknews.com/covid-19-protectionism-the-worst-may-be-yet-to-come-nationalism-trade-supply-chains/

19 https://www.irsg.co.uk/resources-and-commentary/irsg-report-how-the-trend-towards-data-localisation-is-impacting-the-financial-services-sector/

Regulatory fragmentation challenges

The UNCTAD conference in November 2020 highlighted the increasing fragmentation of international economic policymaking, with a shift away from multilateralism and towards bilateralism and regionalism.[20] The UK's G7 presidency should strive to resolve the existing and emerging global regulatory fragmentation challenges. And in doing so, it should build on the legacy of past presidencies. For instance, the Japanese G20 presidency in 2019, recognised the detrimental effect of global regulatory fragmentation and advocated for the inclusion of fragmentation in the FSB's agenda. This work should now be continued.

For instance, the extended Basel III timeline to 1 January 2023 is welcome, but there needs to be global consensus on how to prepare businesses giving sufficient transition time once final rules are established. National regulators have used up much of that time in producing implementing rules, leaving industry with timelines that are difficult to meet. In addition, in the run up to the deadline in 2023, many pandemic regulatory responses will still be ongoing, so it will be important to align timeframes as the financial services system seeks to support the economy through recovery.

Regulators should consider the implications for an international level playing field should the timelines not be resolved on an internationally consistent basis. There is a need to ensure alignment, if not in content, then in timing. Furthermore, it is also important to address expected pandemic corporate credit losses and how inconsistencies in recording these may lead to a lack of comparability of financial performance of the banking system, undermining Basel III. Overall, the pandemic regulatory response has been positive, and we welcome the FSB identifying core principles to drive consistency in national policy making, but some exceptions remain, notably, on accounting, dividends and leverage ratio.

To tackle fragmentation, we would welcome the UK's leadership in calling on the Financial Stability Board for a thorough stock-take of bank branch and subsidiary requirements so that the financial stability and productivity costs of fragmentation can be measured. This will allow to identify financial fragmentation risks to stability and productivity and judge them on their merits under a legitimate analytical framework. As many of the above issues are of particular importance to specific sectors, we expect further, technical detail on these issues to follow from sector-specific organisations.

20 https://unctad.org/system/files/official-document/osg2020d1_en.pdf

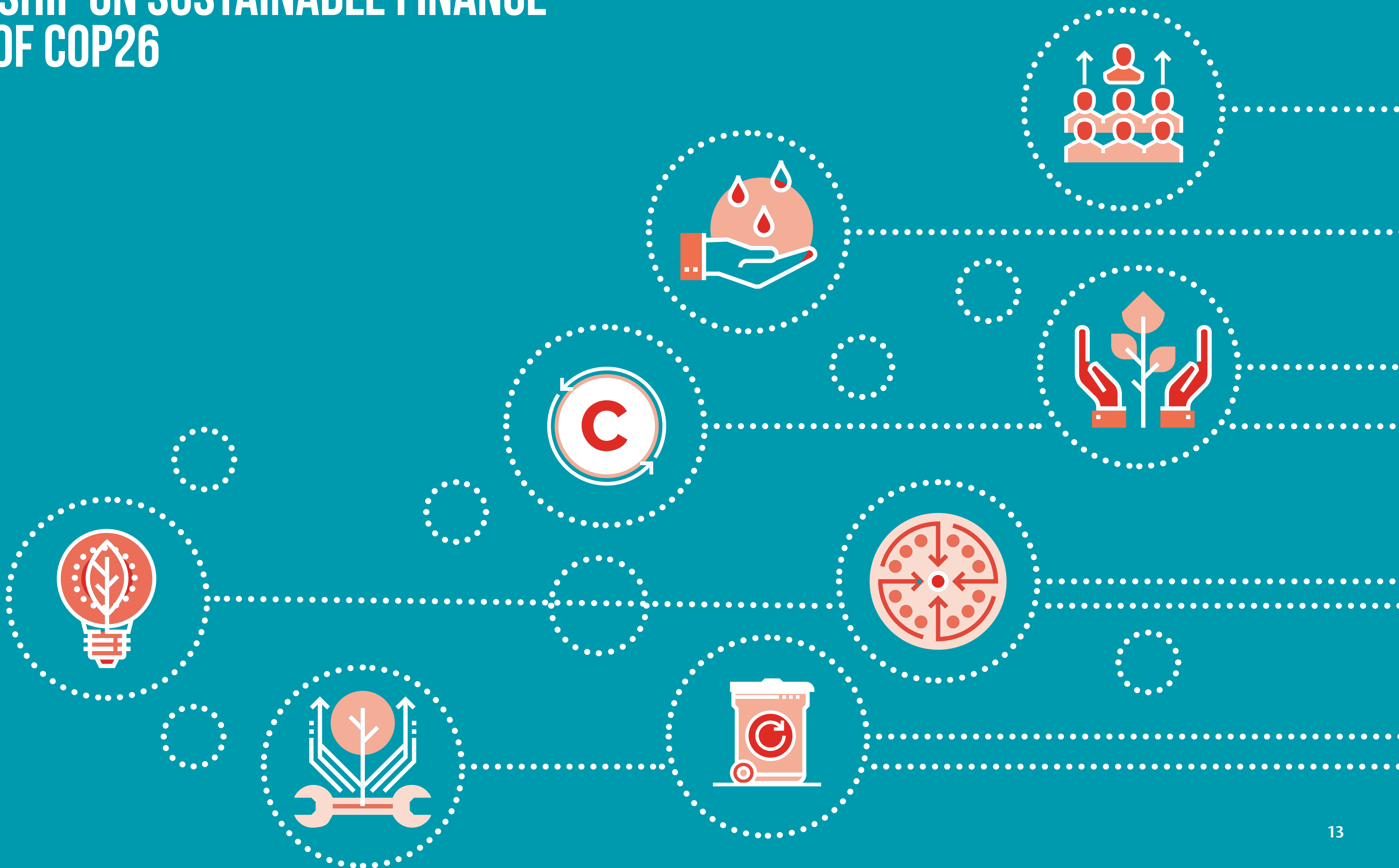
G7 RECOMMENDATIONS:

- G7 to take steps to preserve an open, and resilient financial system, by promoting global trade through a strengthened collaboration with the WTO and championing of its agenda.
- G7 to broker a principles-based approach to data localisation, with jurisdictions accepting that the free flow of data should be the default, with only specific narrow exceptions that are objectively justified; this should include acknowledging and recognising the adherence to core principles of data protection standards, rather than expecting identical laws, developed using the principles set out in Part Two of the OECD Guidelines[21] as a starting point.
- G7 to support the FSB in pursuing its agenda on financial market regulatory coherence to promote strong, sustainable, balanced and inclusive growth.
- G7 to call for the resolution of Basel III timetables, by co-ordinating the implementation of Basel 3.1, synchronising market risk reforms and potentially adjusting the global deadline of 01 January 2023.
- G7 to call for the Financial Stability Board to undertake a stock-take of bank branch and subsidiary requirements.

"The UK can demonstrate leadership by developing proactive policy solutions to help reduce corporate leverage post pandemic."

21 http://www.oecd.org/sti/ieconomy/oecd_privacy_framework.pdf

2. LEADERSHIP ON SUSTAINABLE FINANCE AHEAD OF COP26



With the UK assuming the G7 presidency in January 2021 and co-hosting alongside Italy the 26th UN Climate Change Conference of the Parties (**COP26**) in Glasgow on 1 – 12 November 2021, this is an opportune moment to achieve real progress on the climate agenda through strong leadership on sustainable finance.

Climate, sustainability and responsible finance have emerged as main issues for the FRPS industry. The industry would welcome continued UK focus on furthering policy development on sustainable finance, including on climate-related financial disclosures. This needs to be developed in a way that is sensitive to the rapidly changing dynamics of the market and avoids a level prescription that turns it into a "box ticking" exercise rather something that is embedded in businesses. Commitment to this agenda varies globally and the UK should utilise its presidency to drive progress in this area among the G7 and work with the Italian G20 Presidency to broaden the consensus.

Over the past decade, the UK has cut carbon emissions by more than any similar developed country and was the first major economy to legislate for net zero emissions by 2050. In April the UK Government committed to set in law world's most ambitious climate change target, cutting emissions by 78% by 2035 compared to 1990 levels.[22]

However, the current levels of net-zero investment need to be scaled up rapidly. As the London School of Economics states there needs to be a five-fold increase in extra net-zero investment in the UK from circa £10bn/year in 2020 to around £50bn in 2030 if we were to achieve the target of net-zero.[23] The lack of this investment in emerging markets further compounds the global problem.

The issue of scaling voluntary carbon markets and the industry's approach to fossil fuels is another area of concern. In fact, the recently set up Taskforce on Scaling Voluntary Carbon Markets (TSVCM), sponsored by the Institute of International Finance (IIF) with support from McKinsey, estimates that demand for carbon credits could increase by a factor of 15 or more by 2030 and by a factor of up to 100 by 2050.[24] Nevertheless, current levels of carbon market trading activity require substantial scaling.

The foundation of any green or sustainable investment is data, notably, climate-related and sustainability-related risk reporting and **disclosures** and the related issue of **taxonomies**. On disclosures the FSB's Task Force on Climate-related Financial Disclosures (TCFD) figures are promising with total TCFD supporters: +2,000; market cap: $20 trillion; number of Financial Firms: 880; financial firms responsible for assets of: $178 trillion and number of countries represented: 78.

22 https://www.gov.uk/government/news/uk-enshrines-new-target-in-law-to-slash-emissions-by-78-by-2035

23 https://www.lse.ac.uk/granthaminstitute/news/financing-net-zero-mobilising-the-money-for-action-on-the-ground/

24 https://www.mckinsey.com/business-functions/sustainability/our-insights/a-blueprint-for-scaling-voluntary-carbon-markets-to-meet-the-climate-challenge#:~:text=The%20Taskforce%20on%20Scaling%20Voluntary,up%20to%20100%20by%202050

However, there are still gaps in TCFD adoption amongst jurisdictions, which may prevent flows of investment towards sustainable assets. There is also a lack of global consensus on how to drive global commitment towards TCFD reporting and around the IFRS Foundation's proposal on sustainability reporting and the Sustainability Standard Board. Indeed, the IFRS Foundation can serve as the go-to avenue for addressing fragmentation risk on disclosures. And, on taxonomies, there is not currently one global taxonomy or classification enabling easy comparison of climate and sustainability credentials by companies. The G20 Sustainable Finance Working Group can serve a useful role in developing taxonomy principles, to allow interoperability of taxonomies.

By making faster progress on key elements required to achieve the commitments made in Paris five years ago, G7 leaders can assure a pathway to a successful COP26 in Glasgow and pave the road to deliver net zero emissions globally.

The Government's Green Finance Strategy's objective to align private sector financial flows with green and sustainable growth, in order to consolidate the UK's position as a hub for green finance is equally relevant to both the UK's G7 presidency and the UK's COP26 co-presidency. The UK's leadership can deliver in a number of areas, working towards ensuring that climate and environmental financial risks and opportunities are integrated into financial decision making, and that markets for green financial products are robust and resilient post-crisis.

The IRSG agrees that when promoting and building robust and consistent green financial market frameworks, UK action should broadly focus on two areas - 'greening of finance', such as promoting coherence and global consensus on climate-related risk reporting and disclosures, and 'financing green', such as the development of new green financial products and services, with a commonly-agreed sustainable product naming convention, or improving access to finance for green investment, or building skills and capabilities on green finance. Global efforts to develop taxonomies on climate and sustainability will be a crucial starting point.

To that end, we welcome the Financial Stability Board's efforts to address climate-related financial risks as outlined in Randy Quarles' letter to G20 Finance Ministers[25], which states that in this endeavour towards a coordinated and forward-looking roadmap to address these risks, the FSB has invited the Network for Greening the Financial System (NGFS) to participate in FSB climate-related work, and the FSB will apply for observer status in the NGFS.

25 https://www.fsb.org/wp-content/uploads/P060421-1.pdf

Financing green

Investment flows towards green finance

G7 Finance Ministers and Central Bank Governors should acknowledge that reconfiguring the financial system, while necessary, will not be sufficient to achieve net zero targets. A **whole economy** approach is needed with macro- and micro-economic policy and regulation aligned towards this objective across all sectors. In addition to green and sustainable financial products and services, the global economy needs to recognise the role of **transition** in finance. Most activities can play a part in the transition to net zero and financial sector policy should reflect this. Engagement with rather than divestment from high carbon sectors can support the green transition and investment to transform those sectors rapidly should be prioritised. With that, the role of green taxonomies is crucial to incentivise investments that align with net-zero carbon commitments and the Paris Climate Agreement. In the absence of a clear and robust definition of what constitutes 'green' projects or activities, risks of greenwashing remain and investors will not be able to efficiently compare financial products promoting or presenting environmental characteristics. However, it is important that taxonomies also include transition activities not just dark green activities.

In cooperation with the FRPS sector, the government should utilise its presidency to accelerate the growth of green finance, by catalysing the global investment flows needed, including through new public-private funds, building green skills across the financial sector and mobilising climate finance into **emerging markets**. It should also focus efforts on ensuring as much compatibility as possible between jurisdictions' efforts in this space and drive innovation in **ESG** products with a commonly-agreed product naming convention. The government should work with established organisations, regulators and standard setters in this space to establish long-term policy frameworks through new regulations, including on energy efficiency standards.

G7 RECOMMENDATIONS:

- G7 to continue to promote green and responsible finance for the recovery by working alongside other jurisdictions to ensure compatibility and develop a set of guiding principles for sustainable product naming/labelling, guiding consumers and investment flows towards sustainable assets, and leveraging public-private partnerships to a pipeline of investable opportunities, as well as mobilising climate finance into emerging markets.

- Through the UK's work on COP26, the G7 presidency to promote the role of transition finance towards a whole economy approach to net-zero.

Net-zero and carbon markets

Pricing carbon is recognised by economists as the best mechanism to achieve green transition in the most cost effective way, **Fossil fuel subsidies**, explicit and implicit, are slowing the energy transition and their impact needs to be recognised and reduced, ideally by their removal. This has been committed to many times, but advanced economies must set an example by removing subsidies for fossil fuel. At the same time, **carbon offsetting** has a role to play in achieving net zero and increasing carbon sequestration.

With opportunities arising from COP26, the UK should drive global commitment among the G7, the G20 and beyond towards net zero targets ahead of COP26. Specifically, there is an opportunity for the G7 to support the development of **Core Carbon Principles** by the Task Force on Scaling Voluntary Carbon Markets alongside the set-up of a **governing body**[26].

G7 RECOMMENDATIONS:

- G7 to drive global commitment among the G7, the G20 and beyond towards net zero targets, with the scaling of voluntary carbon markets and robust carbon pricing and net zero finance strategies including with green job creation, ahead of COP26.
- G7 to agree to recognise the role of carbon pricing as a mechanism to assign a real value to emissions reduction.
- G7 to agree to establish principles for credible carbon offsetting to support net zero.
- G7 to support the development of Core Carbon Principles by the Task Force on Scaling Voluntary Carbon Markets alongside the set-up of a governing body.

> **"With opportunities arising from COP26, the UK should drive global commitment among the G7, the G20 and beyond towards net zero targets."**

26 https://www.iif.com/Portals/1/Files/TSVCM_Report.pdf

Greening finance

TCFD disclosures

On climate-related financial disclosures, the UK's G7 presidency presents an important opportunity for the UK to lead on global regulatory coherence issues arising out of insufficient or inconsistent reporting of climate-related and broader sustainability risks. Incoherence and lack of commitment from significant jurisdictions here can present major challenges, and the UK can play a pivotal role in achieving consensus in this area and ensure climate-related risk reporting is robust across the board, globally.

In light of the recent UK TCFD Taskforce Roadmap and the Chancellor's commitment to mandatory **TCFD disclosures** across the UK economy by 2025, the G7 presidency can play a pivotal role in building global consensus towards TCFD reporting. The UK can equally play a role in reinforcing the development of global sustainability disclosure standards following the UK authorities' supportive response to the IFRS Foundation's proposal for a global approach to sustainability reporting and on possible Foundation role. Indeed, the UK is not alone in making strides towards climate risk reporting. For instance, New Zealand has shown leadership on mandatory reporting with the introduction of a climate change law for financial firms.[27]

The intervention of the IFRS towards a global reporting standard is welcome and will assist the progression of climate-related disclosures. We call for regulatory approaches to achieve better and comparable data and disclosure around a harmonised framework/taxonomy as it will support the efficient reorientation of investment towards sustainability, support climate risk management, and reduce risk mispricing.

The IRSG welcomes that FSB has been asked by the G20 to report in July on ways to promote consistent, high-quality climate disclosures that are in line with the recommendations of the Task Force on Climate-related Financial Disclosure and on the data necessary for the assessment of financial stability risks and where data gaps remain.

G7 RECOMMENDATIONS:

- G7 to foster global regulatory coherence on climate-related and sustainability-related risk reporting and disclosures by building global consensus on disclosures and tackling the gaps in TCFD adoption amongst jurisdictions, with driving global commitment towards TCFD reporting and around the IFRS Foundation's proposal on sustainability reporting, making progress on issuer disclosure standards, in collaboration with private standard setters.

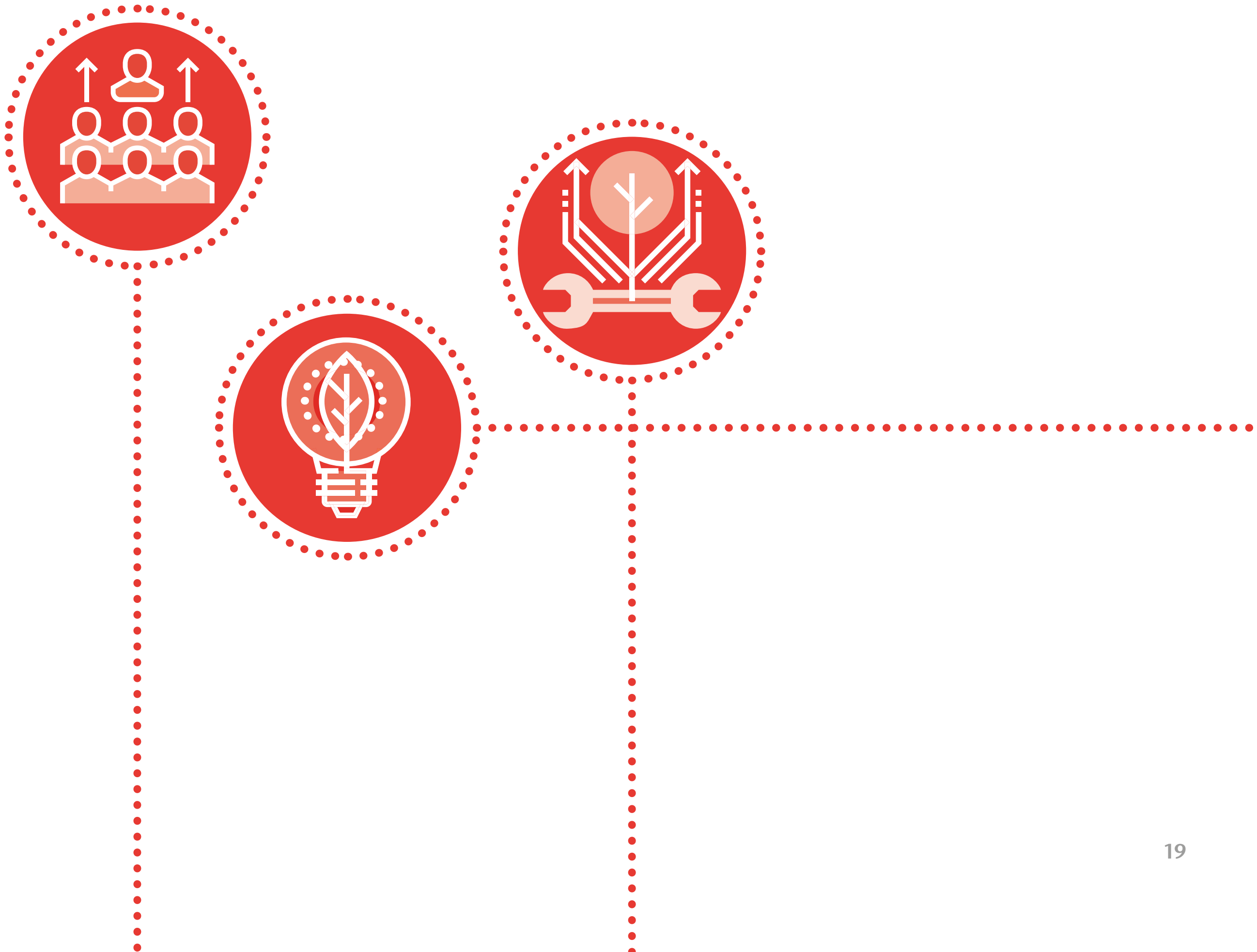
- G7 Leaders to take steps to ensure that the capital framework for the financial sector is sensitive to environmental risks, including but not limited to, climate change.

27 https://www.reuters.com/business/sustainable-business/new-zealand-introduces-climate-change-law-financial-firms-world-first-2021-04-12/

Climate and sustainability taxonomies

While climate and sustainability disclosure will be an immediate priority, it should also be noted that in addition, currently there is no global classification for climate and sustainability. Jurisdictions have chosen to approach this at differing speeds, with some, notably the European Union, moving ahead with the creation of its own taxonomy while others have lagged behind.

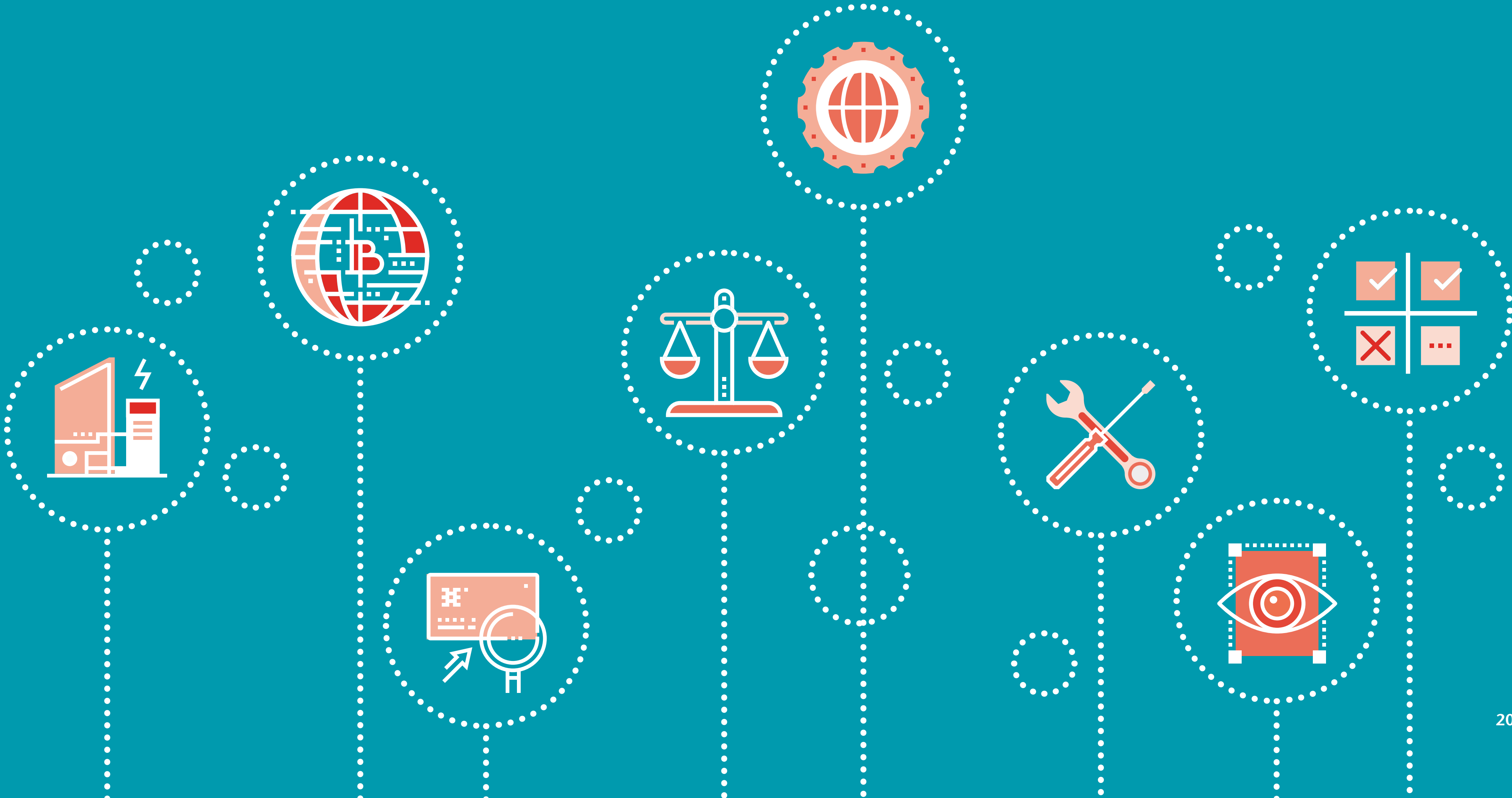
To avoid fragmentation in this space, the UK's G7 presidency should drive agreement towards the alignment of taxonomies and classification frameworks around core principles including harmonised reporting, recognition of location of the activity being classified, and accommodating transition, particularly in less developed economies. We suggest that the new IFRS proposed **Sustainability Standards Board** is used as a vehicle for this and for aligning taxonomies, especially in light of the FSB's endorsement of IFRS.



G7 RECOMMENDATIONS:

- G7 to agree to commission, in partnership with the G20, the development of a common set of core/guiding principles to inform the design of sustainable taxonomies, enabling interoperability, and the mapping of transition as well as 'transited' activities.

3. DIGITAL POLICY CONTINUITY, INCLUDING ON DIGITAL TAXATION



The UK's G7 presidency predecessors prioritised digital policy during their presidencies. Both, France and the United States made inroads on digital policy, including on data and technology, as well as digital taxation. The OECD has led work in this area with its digital taxation framework and the UK should, through its G7 Presidency help reach an agreement on this framework, as well as advance digital policy work initiated by past presidencies. We welcome the G7 Ministerial Declaration published on 28 April, which sets out the G7's commitment to working together across vital areas of digital policy[28].

The pandemic has **accelerated digitalisation** and with this, the FRPS sector, too, has experienced challenges and opportunities. As FRPS workforces have migrated to working online, the issue of digitally upskilling the general workforce and boosting employment in IT skills has become even more pertinent. According to a report commissioned by The Open University, one in three (32%) senior business leaders report that their organisation does not have the skills required to adapt to new technologies, which many believe is already having an impact on productivity. In the South West of England, this issue is even more prevalent, with 56% of employers reporting that their organisation lacks the skills required. Moreover, the UK skills shortage is costing organisations £6.3 billion.[29]

This year, we have also witnessed the systemic importance of digital technology provision for business. Last year, the FSB warned banks about the "possibility of systemic risk" from **outsourcing** to a few third-party technology companies. In the wake of the Wirecard scandal, the FSB raised concern over a trend for financial institutions collectively to use fewer third-party technology providers, indicating that a fault in one third party may lead to financial instability.[30] The IRSG welcomed the FSB's public consultation on the discussion paper on *Regulatory and Supervisory Issues Relating to Outsourcing and Third-Party Relationships* and responded to it last year, setting out its preferred approach to outsourcing.[31]

Cyber security has been impacted by the changing landscape of digital provision. Earlier in the paper, we shared how reputational issues for the financial services sector have come to the fore with online financial scams on the rise and the work done by industry bodies such as UK Finance to tackle online crime. With that, come questions to governments and regulators about how they regulate and supervise the digital landscape and what is required to do so efficiently. A coherent approach to **digital taxation** and a **global data standard** is crucial.

"The pandemic has accelerated digitalisation and with this, the FRPS sector, too, has experienced challenges and opportunities."

28 https://www.gov.uk/government/publications/g7-digital-and-technology-ministerial-declaration
29 http://www.open.ac.uk/business/apprenticeships/blog/uk-skills-shortage-costing-organisations-%C2%A363-billion

30 https://www.technologymagazine.com/it-procurement/outsourcing-technology-systemic-risk-banks
31 https://www.fsb.org/wp-content/uploads/International-Regulatory-Strategy-Group.pdf

Digital taxation

The IRSG welcomes policy continuity in this area, to utilise the momentum already achieved among the G7. With its digital expertise, the UK is well placed to drive consensus on issues such as digital taxation during its presidency. We welcome the commitment from the G20 to finalise this work by mid-2021, and the G7 has a critical role to play in helping lay the foundations for a consensus at the G20.

G7 RECOMMENDATIONS:

- G7 to support continuity on G7 policy on digital taxation, by calling for an agreement on the OECD's digital taxation framework this year.

Outsourcing

Many challenges in this area will be new and time-sensitive, and the UK's leadership of the G7 this year has the potential to achieve significant progress here. The IRSG recognises the potential risk arising from the concentration of outsourcing to large technology vendors, which is especially pertinent now due to the increasing reliance on technological solutions post-pandemic and the rise of home working.

The IRSG also notes that more recently, the UK's Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) have focused on interdependencies of the financial system (3rd party included) and the non-technology risks associated with third parties, as highlighted in the FCA's Policy Statement 21/3 on operational resilience: *"Generally respondents had a positive experience with the scalability and security of services received from cloud providers, but the pandemic highlighted increasing dependence on third parties and outsourcing arrangements. For example, some firms experienced challenges with offshore third-party providers, particularly where providers were under lockdown in another geographical location, which affected continuity of service to UK consumers".*[32]

The PRA's Supervisory Statement 2/21 on outsourcing and third-party risk highlighted that intra-group arrangements can pose similar risk as "material outsourcing", and highlighted a "technology agnostic" view to "materiality".[33]

32 https://www.fca.org.uk/publication/policy/ps21-3-operational-resilience.pdf
33 https://www.bankofengland.co.uk/prudential-regulation/publication/2021/march/outsourcing-and-third-party-risk-management-ss

It is evident that in the context of operational resilience, policymakers and financial regulators need to co-ordinate their efforts to ensure regulated entities have appropriate risk mitigation measures for such a risk. Any solution is likely to involve more direct co-operation between large vendors and regulators, with co-ordinated approaches to risk mitigation and management. The technology sector has also done considerable work during the pandemic in enabling large-scale home working globally.

Crucially, it is important to recognise that market-wide concentration risk is not something that can be fully managed by individual financial institutions themselves, short of withdrawing from key contracts that in many cases are not easily substitutable. Many large technology vendors provide crucial services that benefit financial institutions and their customers via cost and efficiency savings as well as resiliency benefits and IRSG does not therefore believe that ending contracts with vendors due to market-wide concentration risk is a viable or desirable solution. It is important to foster the end-to-end assessment of vulnerabilities from a services lens and to focus on greater use of forecasted scenario analysis.

The IRSG welcomed and responded to the FSB's recent consultation on this topic and value the UK's current leadership in furthering this work. There is a need for a wider cross-government approach to management of outsourcing policy challenges and G7 leaders can set an early example that co-operative solutions can be found to avoid fragmentation and the promotion of national champions.

G7 RECOMMENDATIONS:

- G7 to drive the development of a consistent global regulatory approach and methodology, with cross-governmental support, including to address market-wide concentration risk from outsourcing to large technology vendors and prevent the localisation of data.

"There is a need for a wider cross-government approach to management of outsourcing policy challenges and G7 leaders can set an early example."

Global data standard

The presidency is also an opportunity to call for a global standard on data across the G7 and G20 to tackle fragmentation risks from data localisation laws across jurisdictions. The UK should lead the charge towards greater international consistency around privacy regulation as this would greatly facilitate global data flows. As mentioned earlier, data localisation and global regulatory fragmentation can increase risks including cyber security and anti-money laundering.

Global data flows represent the next frontier of global cooperation, and following the G20's lead, the G7 should explore how the free flow of data can be facilitated via a global data standard. This and a more effective global governance will be critical to facilitating global economic growth and ensuring that small and developing countries can continue to participate in the global economy. Groundwork has been laid with agreements such as the USMCA, CPTPP, Japan/UK, which are all FTAs with comprehensive data localisation provisions. A new network of advanced digital agreements is being developed which include the Singapore-Australia digital economy agreement.[34] At the multilateral level, some of the same issues are relevant to the WTO E-Commerce JSI, OECD data protection standards and the Council of Europe's Convention 108, all of which may contribute to global data standards.

The G7 is ideally placed to encourage progress in this area given the ability of a relatively small number of like-minded jurisdictions to set the standard on what good looks like and to broker a core critical high-level commitment globally. Ideally, G7 national authorities would consider a common framework that establishes what tools and procedures could be used to address common localisation issues, and a process for establishing cost-benefit considerations where these do not apply so that a localisation decision is subject to appropriate scrutiny.

Appreciating that arriving at a global data standard may be a lengthy process, immediate steps should be taken en route to a standard. To that end, data interoperability through a global taxonomy on data will be the first necessary step to take.

G7 RECOMMENDATIONS:

- G7 to address the lack of a global data standard, and to agree to examine a framework that could improve the global governance framework for data flows. This may include a new global body to create and manage a global data standard on data governance, with data interoperability through a global taxonomy on data being its first task.
- G7 to promote greater international consistency around privacy regulation to facilitate global data flows by increasing mutual trust in other jurisdictions' privacy regimes.
- G7 to develop a common framework for managing regulatory intentions to requiring the localisation of data and seek alternative solutions where possible.

34 https://www.dfat.gov.au/trade/services-and-digital-trade/australia-and-singapore-digital-economy-agreement

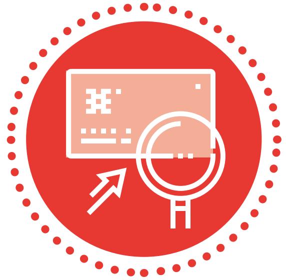
Cyber security

To leverage UK's expertise in this area, we would also welcome UK's leadership in promoting public-private partnership models on anti-money laundering and cyber security measures, with the objective to tackle global financial crime, which is a major drain on the economy.

Growing financial market fragmentation, and politicisation of financial infrastructure through sanctions that isolate jurisdictions, increase the risk of state-sponsored cyber-attacks on systemic financial services market infrastructure and banks. We recommend the G7 Leaders should establish a principle to 'do no harm' to financial services systems among like-minded countries to set an example to wider groupings such as the G20. The Cyber Security Profile[35], managed by the Cyber Risk Institute, referred to as the Profile, is a powerful tool to assist banks to mitigate the cost of fragmented cybersecurity regulations – incorporating national requirements from across the globe. Over time, it should become the accepted supervisory base-line upon which national variations can be established so supervisors and banks alike can more efficiently use scarce cyber security expertise.

G7 RECOMMENDATIONS:

- G7 to lead on combating economic crime, corruption and illicit finance by tasking the G7 Cyber Expert Group to develop methodologies to achieve a common regulatory and supervisory approaches to achieve global beneficial ownership reform.
- G7 to call for the adoption of the Profile managed by the Cyber Risk Institute as the accepted supervisory base-line upon which national variations can be established for supervisors.



"The Cyber Security Profile is a powerful tool to assist banks to mitigate the cost of fragmented cybersecurity regulations. Over time, it should become the accepted supervisory base-line upon which national variations can be established."

35 https://cyberriskinstitute.org/the-profile/

4. ALIGNMENT WITH G20 GLOBAL POLICY PRIORITIES

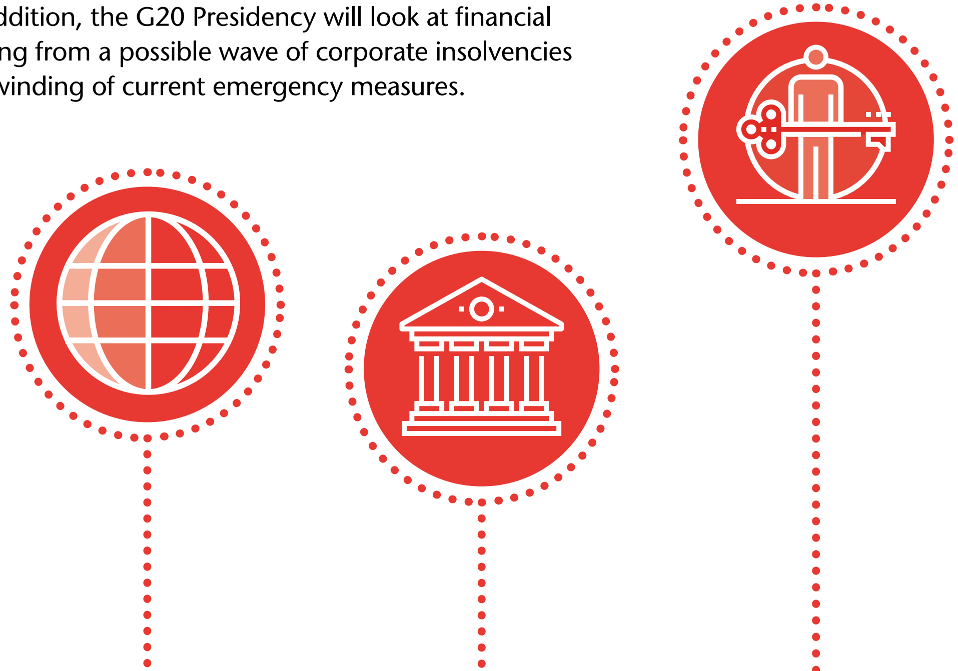
It will be important for the UK's presidency to align with the G20's wider objectives for the global economy. This will call for a nuanced approach, bearing in mind the potential tensions arising between the priorities for the global economy and those for individual countries, different countries' strategies for reshoring or shortening global supply chains, and the likelihood of policies to address perceived disadvantages and/or adverse effects of globalisation. Discussion among the G20 is bound to be affected by these issues. We would urge nonetheless that there should be a focus on specific objectives for financial services with an eye to continuity in addressing key themes, as outlined by the Saudi G20 presidency. These include promoting sustainable and inclusive pandemic recovery, fostering private sector participation in infrastructure investment and promoting digital financial inclusion. The UK should use its G7 Presidency to:

- Leverage cooperation on financial services policy with Italian G20 presidency for recovery;
- Support continuity on financial services objectives of Saudi G20 presidency and continuity on fragmentation agenda highlighted by the Japanese G20 presidency.

G20 cooperation and policy continuity

The UK's G7 presidency provides an opportunity to engage with other major economies and promote the FRPS industry asks, through closer alignment with the G20. The UK's G7 presidency should prioritise engagement and closer policy alignment with its Italian G20 presidency counterparts, to utilize the opportunity to bring key global decision makers together to address the pandemic and to promote the importance of joint action. Indeed, synergies have already emerged between this year's G7 themes of Response, Recovery and Resilience and G20 themes of Population, Planet and Prosperity.

For Italy's G20 presidency, the latter three will be key themes this year with inclusion as a cross cutting issue. In light of Covid-19, Italy has indicated for banks and non-bank regulation a focus on potential flexibility for prudential standards, potential sources of pro-cyclicality, as well as a review of the adequacy of the existing crisis management frameworks. In addition, the G20 Presidency will look at financial stability risks arising from a possible wave of corporate insolvencies as well as the unwinding of current emergency measures.



Furthermore, in response to the clear evidence towards a shift to more sustainable investment since the outbreak of COVID-19, the Italian Presidency should continue to encourage, through properly designed regulation and the adequate provision of information, preventing the risk of "green washing" practices in the provision of sustainability scores by the rating industry. In the lead up to COP26, the Italian Presidency should strive to bring "climate cooperation" to the centre of debate also within the G20.

Digital and financial awareness is a second major theme. The Bank of Italy is committed to delivering on the G20 financial inclusion agenda. The Presidency will look to foster more innovative regulatory and supervisory approaches to steer and encourage the development of inclusive and responsible digital financial services while granting an adequate protection to final customers, not least from cyber risk.

It will also be important for the UK's presidency to align with the G20's wider objectives for the global economy, but also on specific objectives for the financial services sector. In this regard, we would welcome continuity on key themes for financial services, as outlined by the Saudi G20 presidency, including promoting sustainable and inclusive pandemic recovery, fostering private sector participation in infrastructure investment, smooth transition away from LIBOR, addressing capital flow volatility, and promoting digital financial inclusion.

G7 RECOMMENDATIONS:

- G7 to leverage cooperation on financial services policy with Italian G20 presidency for recovery via the mechanism of G7 and G20 Ministerial meeting schedule and key stakeholder bodies, such as cooperation with the B20 Finance and Infrastructure Taskforce.
- G7 presidency to leverage COP26 as an opportunity to maximise its legacy on mutual climate and sustainability deliverables via cooperation with Italy's G20 presidency.
- G7 to support continuity on financial services objectives of Saudi G20 presidency by reflecting progress made on key deliverables such as financial inclusion, in the UK's G7 agenda.

> **"The Italian Presidency will look to foster more innovative regulatory and supervisory approaches to steer and encourage the development of inclusive and responsible digital financial services while granting an adequate protection to final customers, not least from cyber risk."**

CONCLUSION

It is evident that there are a number of areas where the UK government can achieve significant progress during its G7 presidency, be it on pandemic recovery, on climate or on the digital agenda, by building on the efforts of its G7 presidency predecessors, and through collaboration with its counterparts in the Italian G20 presidency next year, and the UK FRPS industry believes that it can offer a valuable contribution to this work.

ANNEX
G7 RECOMMENDATIONS

1. GLOBAL REGULATORY COHERENCE FOR PANDEMIC RECOVERY, RECAPITALISATION AND RESOLUTION

- G7 to aid the set-up of public-private forums to develop new schemes and run corporate education programmes, building on existing thought leadership on recapitalisation.

- G7 to ask the Financial Stability Board to convene a forum of its membership to share best practice and draw up a plan on securing corporate recapitalisation at scale, based on productive finance principles, including a menu of options for addressing zombie debt risks arising from the pandemic.

- G7 to take steps to preserve an open, and resilient financial system, by promoting global trade through a strengthened collaboration with the WTO and championing of its agenda.

- G7 to broker a principles-based approach to data localisation, with jurisdictions accepting that the free flow of data should be the default, with only specific narrow exceptions that are objectively justified; this should include acknowledging and recognising the adherence to core principles of data protection standards, rather than expecting identical laws, developed using the principles set out in Part Two of the OECD Guidelines[36] as a starting point.

- G7 to support the FSB in pursuing its agenda on financial market regulatory coherence to promote strong, sustainable, balanced and inclusive growth.

- G7 to call for the resolution of Basel III timetables, by co-ordinating the implementation of Basel 3.1, synchronising market risk reforms and potentially adjusting the global deadline of 01 January 2023.

- G7 to call for the Financial Stability Board to undertake a stock-take of bank branch and subsidiary requirements.

36 Accessible at http://www.oecd.org/sti/ieconomy/oecd_privacy_framework.pdf

2. LEADERSHIP ON SUSTAINABLE FINANCE AHEAD OF COP26

- G7 to continue to promote green and responsible finance for the recovery by working alongside other jurisdictions to minimise divergence and develop a set of guiding principles for sustainable product naming/labelling, guiding consumers and investment flows towards sustainable assets, and leveraging public-private partnerships to a pipeline of investable opportunities, as well as mobilising climate finance into emerging markets.

- Through the UK's work on COP26, the G7 presidency to promote the role of transition finance towards a whole economy approach to net zero.

- G7 to drive global commitment among the G7, the G20 and beyond towards net zero targets, with the scaling of voluntary carbon markets and robust carbon pricing and net zero finance strategies including with green job creation, ahead of COP26.

- G7 to agree to recognise the role of carbon pricing as a mechanism to assign a real value to emissions reduction.

- G7 to agree to establish principles for credible carbon offsetting to support net zero.

- G7 to support the development of Core Carbon Principles by the Task Force on Scaling Voluntary Carbon Markets alongside the set-up of a governing body.

- G7 to foster global regulatory coherence on climate-related and sustainability-related risk reporting and disclosures by building global consensus on disclosures and tackling the gaps in TCFD adoption amongst jurisdictions, with driving global commitment towards TCFD reporting and around the IFRS Foundation's proposal on sustainability reporting, making progress on issuer disclosure standards, in collaboration with private standard setters.

- G7 Leaders to take steps to ensure that the capital framework for the financial sector is sensitive to environmental risks, including but not limited to, climate change.

- G7 to agree to commission, in partnership with the G20, the development of a common set of core/guiding principles to inform the design of sustainable taxonomies, enabling interoperability, and the mapping of transition as well as 'transited' activities.

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- G7 to support continuity on financial services objectives of Saudi G20 presidency by reflecting progress made on key deliverables such as financial inclusion, in the UK's G7 agenda.

IRSG

INTERNATIONAL
REGULATORY
STRATEGY GROUP

The International Regulatory Strategy Group (IRSG) is a practitioner-led group comprising senior leaders from across the UK-based financial and related professional services industry. It is one of the leading cross-sectoral groups in Europe for the industry to discuss and act upon regulatory developments.

With an overall goal of promoting sustainable economic growth, the IRSG seeks to identify opportunities for engagement with governments, regulators and European and international institutions to advocate an international framework that will facilitate open and competitive capital markets globally. Its role includes identifying strategic level issues where a cross-sectoral position can add value to existing views.

TheCityUK and the City of London Corporation co-sponsor the IRSG.

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