2021 Europe - U.S. Symposium on Building the Financial System of the 21st Century
Discussion Topic:
Sustainable Finance and Capital Markets – Asset Management and Public Company Governance and Disclosures
Harmonizing Standards – Timing and Process

• EU is strong first mover among official actors
  – Will rest of world follow or fragment?
  – If EU becomes de facto global standard, will U.S. stand alone (“GAAP model”) or converge?
• Role of standard-setting bodies – ISB, IFRS, TCFD
  – Considerable progress
  – Should environmental standards be subsumed under accounting standards?
• Is private standard-setting feasible or desirable?
  – Rapid growth of green finance suggests change can be driven by private demand
  – Can be modified more rapidly in response to changing science and data
  – But is it desirable? We don’t outsource other urgent public policy matters (civil rights, pandemic management) to investor preferences
• Fragmentation of standards – public vs. private, across jurisdictions
  – Fragmentation will lead to higher compliance costs for multinationals
  – Potential for regulatory arbitrage and pollution havens
  – How to incorporate private companies?
    • If only public companies regulated, gaps and regulatory arbitrage will arise
EU vs. U.S. Approaches

- EU sense of urgency far exceeds U.S.
  - Prioritizes immediate start to compulsory standards
  - Allows for modification over time
  - U.S. prefers fixed rules rather than moving target
- “Outside-in” (investor protection-focused) vs. “inside-out” (social impact)
  - EU approach is both inside-out and outside-in; U.S. is outside-in
- Is financial supervision an alternative to direct regulation of corporate activity?
  - In EU, complements holistic approach
  - Is U.S. seeing financial supervision and accounting standards as substitute?
  - Many observers call for an integrated strategy across government functions and private sector
- Enforceability
  - Will there be safe-harbors, phase-in, mutual recognition?
  - How will enforcement be managed along the value chain – i.e., to incorporate environmental impacts of borrowers, supplier networks, etc.?
Data Challenges

• Reducing data inconsistency is an urgent task
  – Data standards can be harmonized even if performance standards differ
  – Increasing quality – what activities actually have the most impact?

• Costs of generating and verifying data potentially very high
  – Can all companies and financial institutions absorb them?

• Reporting along the value chain
  – What are banks’ responsibilities for borrowers, firms’ responsibilities for suppliers?
  – Necessary in order to prevent leakage, outsourcing of polluting activities
  – Scope 1 disclosures (firms’ direct impact on environment) much simpler than Scope 3 (impact of tertiary customers)
  – Quality of data, ease of enforcement decline along value chain
Analytical Challenges

• Cause-effect relationships (or magnitude of effects) not fully established
  – What are actual impacts of corporate actions on environmental outcomes?
  – Are current regulations focused on the highest-impact issues?
  – How to gauge environmental effects on default risks and corporate profitability?
• Incorporating environmental data into effective regulation
  – Need to create metrics and parameters for bank stress tests
  – Accounting standards need to clearly link environmental inputs to corporate risk, profitability – how to do “impact accounting”?
• Environmental accounting and green investing may lead to distortionary effects across sectors unless entire value chains taken into account
  – Services firms will consistently appear to have lower environmental impact
  – But they may depend on activity down the value chain, like rare earth mining, that do have impact
UPCOMING EVENTS


Japan-US Symposium- Nov 8-9, 2021

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