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

China-US Symposium- Oct 27-28, 2021

Japan-US Symposium- Nov 8-9, 2021

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