



2022

*Europe - U.S. Symposium on Building
the Financial System of the 21st
Century*





Sustainable Finance: Capital Markets and the Banking System



What is the nature of the climate challenge?

- **Systemic risk**
 - Predictions of catastrophic change to agriculture, habitability, extinctions
 - Could lead to widespread damages - wildfires, hurricanes, flooding
 - Massive stranded assets
 - Delayed response will make both climate change and eventual responses more severe
- **Endemic condition**
 - Large-scale change, but over the space of decades
 - We've seen large-scale gradual change before - industrial revolution
 - Technological change and investment will respond to changed incentives
 - Financial institutions will act in their own interests



Approaches to addressing climate change

- Risk mitigation vs industrial policy
 - US focused on financial risk mitigation and “nudges”
 - EU looking to directed lending - green:brown ratios, mandates, etc.
 - Investment \neq innovation - which are called for?
 - Do governments need to insure transition risk?
- Where does prudential bank regulation fit with overall policies?
 - Challenges of forward-looking scenario analysis
 - Role of carbon markets, regulation, subsidized R&D and infrastructure
 - Is bank regulation a substitute or a complement?
- Widespread agreement on importance of disclosure and data
 - Are measures and metrics up to the task?
 - Challenges: greenwashing, arbitrary taxonomy definitions
 - Does disclosure change behavior? At what cost?
 - Do investors care? Scope 1, 2, 3



Managing climate risk

- Will regulation just shift risk to less regulated entities?
 - From banks to markets
 - From public to private markets
 - Onshore to offshore
 - How far should we extend the regulatory perimeter?
- Climate and ESG classification considerations
 - Relationships between asset managers and credit rating agencies
 - Benchmarking and arbitrary definitions can lead to rapid movements of funds in and out of equities and debt markets
- Political risks
 - Is policy change the biggest risk?
 - Is the bigger danger underreaction or overreaction?



International cooperation for sustainable finance

- Who should make standards?
 - Official actors - IOSCO, Basel Committee, FSB
 - Governments - EU, US, China, India?
 - Non-governmental - IFRS, SASB, Climate Action 100+
- Future of ISSB
 - Will it be incorporated into IFRS reporting standards?
 - Will it be widely accepted and implemented?
- EU as front-runner
 - Will the rest of the world follow?
 - US as alternative
 - Developing countries may have a veto
 - Fragmentation of standards likely



The Future of Capital Markets: Policy Issues in Primary and Secondary Markets

Are capital markets really resilient?

- Effective management of March 2020 crisis
 - Post-GFC regulations allowed banks to remain active participants
 - Some NBFIs contributed to liquidity
 - ETFs, pension funds, insurers
- Challenges to market liquidity and resilience
 - Ability of national regulators to manage global markets in question
 - Counterparty risk
 - Settlement uncertainties
 - Private markets
 - Must improve venue resilience



Challenges to market liquidity

- Massive growth in public and private debt markets
- Supplemental leverage ratio
 - “Poster child for adverse effects of bank regulation on capital markets”
 - US gold-plating has effectively created 5% SLR
 - If it’s not reformed, could damage Treasuries markets
 - Does it make sense to apply SLR to former investment banks?
- Other regulatory issues
 - CCAR - does it require too much capital?
 - US GSIB surcharge methodology punishes capital market activity
 - Volcker Rule



Potential causes of runs and liquidity freezes

- **Crypto**
 - Right now, links to the financial system are limited
 - Stablecoin as potential avenue for contagion to financial system
 - Asset-backed stablecoins as unregulated MMF
 - Algo stablecoins not connected but potentially dangerous
 - Can we keep these systems separate?
 - ECB seeks to exclude new players, while US seeks to incorporate in existing system
- **Private markets?**
 - Lack of visibility, rising leverage
 - How to understand links to public?
- **Commodities markets (LME nickel run)**



Global issues

- Dash for dollar liquidity
 - Pandemic sparked dollar funding crunch, esp. for offshore holders
 - EMs are particularly endangered
 - Rising interest rates worsen dash and increase probability of solvency crises
- Role of the Fed
 - Global lender of last resort
 - Moral hazard and TBTF
 - Does each rescue sow the seeds of the next crisis?
 - Need more resilient liquidity mechanisms in global dollar market
 - FIMA reserve repo facility can help
 - How to tell if problem is liquidity or solvency?
- Political crisis?
 - Rising populism and resentment of financial and governmental actors
 - Difficulty of legislation is shifting policy to regulatory agencies



UPCOMING EVENTS

2022

China - U.S. Symposium

September 28-29, Virtual

Japan - U.S. Symposium

Dec 1-3, Washington, DC

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