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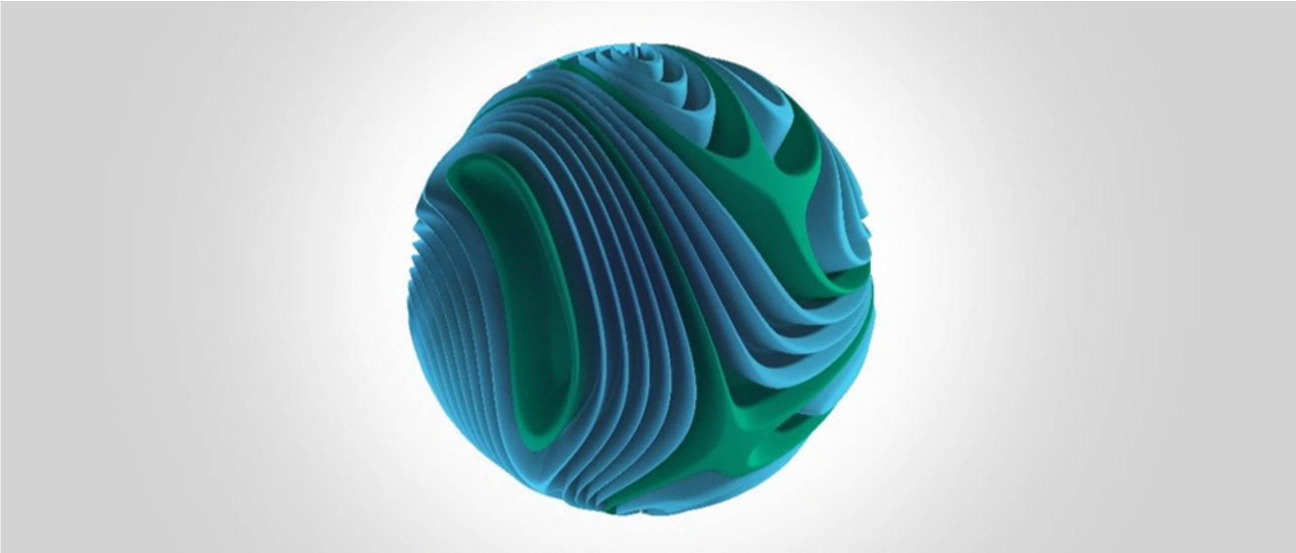

Freshfields FS insights

Political and societal change – Revisiting developments

A new consensus is developing amongst leaders in the EU, UK and US to place the environment at the heart of the financial system and in support of government intervention to allow the financial services sector to build back better, particularly when compared to the recovery plans following the Global Financial Crisis. However, there remain important areas of difference and tensions (for example, around sanctions) and even when there is broad consensus on objectives, divergences in approach to implementation pose challenges to the financial services sector. We explain how these tensions are playing out.

The return of cooperation?

As part of the recent G7 meeting, Finance Ministers and Central Bank Governors, as well as the Heads of the International Monetary Fund (IMF), the World Bank, the Organisation for Economic Cooperation and Development (OECD), and the Financial Stability Board (FSB) presented an agreed communiqué that looks towards convergence in a number of important areas, pledging "to work together to ensure a strong, sustainable, balanced and inclusive global recovery that builds back better and greener from the Covid-19 pandemic." Similar statements are expected by the G20 when it meets in October 2021 following preliminary meetings this month. The main areas of global cooperation in the financial services arena include building a strong, global, inclusive recovery from the pandemic; aiming to "green" the global financial system; considering the implications of central bank digital currencies; cooperating to provide common standards for cryptocurrencies; and combatting money laundering and terrorist financing.

A Green Global Financial System

As we previously noted, we envisage significant developments on the sustainability regulatory horizon as part of global consensus to combat climate change. International accords such as the Paris Agreement, as well as pressure from some of the world's largest investors and the shareholder/stakeholder debate continue to provide further impetus for change. Regulators have sought to address concerns of competing standards and pledged support to "a very promising pathway to global convergence" towards achieving sustainability. The Hong Kong SFC's CEO, who is also chair of the IOSCO Board, has stressed the importance of establishing globally consistent corporate sustainability reporting standards, and sought to quell emerging concerns that the IFRS approach and the different approaches in the EU could result in inconsistent or even conflicting standards. The G7 has endorsed a move towards mandatory climate-related financial disclosures that are based on the Task Force on Climate-related Financial Disclosures (TCFD) framework.

Further Areas of Consensus: Tax, Digital and Financial Crime

Additional areas of potential consensus may follow from a global tax agreement, the UN General Assembly statement that commits to implementing the Financial Action Task Force Standards to combat money laundering and a statement supporting the regulation of digital currencies (following the Basel Committee consulting on stricter crypto-asset regulation).

Looming uncertainty?

The G7 summit was marked by a cooperative approach often absent in recent summits. In turn, convergence could benefit the financial sector, allowing it to operate more effectively across borders as states seek to align policies to allow seamless business internationally. However, there are potential areas of divergence.

Divisions beneath the surface

Despite the recent words of alignment, there remain areas where countries' approaches are diverging, as evident from the continued divisions between the EU, UK and US, as compared to China and Russia. The recent NATO communique declares that the Euro-Atlantic will diverge from Russia and China to combat "Russia's aggressive actions" and "China's growing influence and international policies", which pose emerging threats from "disinformation campaigns, and by the malicious use of ever-more sophisticated emerging and disruptive technologies," as well as from “Climate change”. Similarly, the G7 voiced continued criticism of China, including in relation to human rights abuses, the autonomy of Hong Kong and trade. The recent HMS Defender incident between the UK and Russia also shows how rhetoric can quickly spiral into tension in practice that threatens economic stability.

Increasing use of sanctions

The EU and the US have recently resorted to sanctions tools to tackle feared threats. The EU has taken a new approach to strengthen its economic sanctions in light of US extraterritorial sanctions and has recently tightened its sanctions grip on Belarus. The US has expanded sanctions against Russia and, in early June, reset the sanctions regime against China. In response, China’s new Counter-Foreign Sanctions Law came into effect on 10 June, which represents the strongest countermeasure to date and, unlike previous steps, is less likely to be merely symbolic. The proliferation of sanctions creates continued difficulties for the financial sector in managing rapidly changing, sometimes diverging, regimes, as illustrated by the tension between EU and US extraterritorial sanctions.

EU/UK Divergence

There remain differences between the UK and EU post-Brexit. The post-Brexit EU/UK Memorandum of Understanding concerning financial services remains to be signed and provides merely for voluntary cooperation and dialogue, rather than containing any concrete proposals or granting any single market access to the UK. The UK Treasury and LSEG have in turn called on the EU for more co-operation on financial services post-Brexit. The UK Government is pursuing several opportunities opened up by Brexit, focusing primarily on the UK’s new freedom to do its own trade deals around the world and the ability to adapt its regulatory regime to suit its own needs which means we are starting to see the first signs of divergence between the UK and EU. The hope is to negotiate better access to foreign markets and attract liquidity and activity to the UK.

Divergence in Implementation

A related issue for stakeholders to consider is that, whilst there has been a convergence at the international/global level with respect to the overall policy objectives on certain topics (e.g., sustainable finance, digital currencies, and AML standards), there is plenty of scope for different approaches to be taken to the detailed rules underpinning this, which – as in many other situations, historically - are likely to be fragmented. Moreover, mere statements may not mark concrete steps in practice.

For example, operational resilience has seen broad agreement in approaches by the EU, UK, and US, but concerns persist regarding different standards, which are difficult to implement across borders. The new regulations in this area include:

- US regulators have recently announced final guidance on Sound Practices to Strengthen Operational Resilience;
- the EU is expected to implement the Digital Operational Resilience Act as part of its cybersecurity strategy for 2021 and beyond; and
- the UK FCA and PRA will implement revised standards for outsourcing and operational resilience this year.

Taken together, the proliferation of guidelines and requirements represent a major compliance exercise for financial service firms. With the scope for both significant overlap and divergence between approaches developed at the national and international level and across various sub-sectors of financial services, it is essential that firms prepare to respond to the fast-pacing changing area.

The divergences over green taxonomies also highlights the challenge of aligning regulation, not just policy. The EU's 2020 taxonomy regulation established a landmark framework for ensuring that economic activity in the region meets conditions that qualify as environmentally sustainable, which was followed by the Benchmark and the Sustainable Finance Disclosure Regulations as part of the EU's actions to support sustainable finance disclosure.

However, the UK decided not to follow the EU's approach. The Government recently announced that it had established a working group to help to create its own green taxonomy, marking the first steps towards a taxonomy aimed at addressing greenwashing of investments in the UK.

Meanwhile, as part of the Biden administration's sustainability policies, the US is also expected to introduce its own taxonomy. Earlier this year, the US Securities and Exchange Commission (SEC) announced the creation of a Climate and ESG Task Force within the Division of Enforcement. More recently, SEC Chair Gary Gensler stated that climate-related disclosure is a top priority for the Commission and met with President Biden, Treasury Secretary Yellen, and other financial regulators to address the issue. Gensler also noted that he has directed his staff to propose changes to require greater disclosure of information on greenhouse-gas emissions. Precisely what type of disclosures will be implemented (and their scope) has sparked an active debate.

In this environment, General Counsel are struggling to assess the proliferation of ESG standards to follow in different regions. Although the IFRS and IOSCO are now looking to work together to reach consensus in this area, the current lack of consistency globally reinforces the difficulties for companies choosing any voluntary regime to implement.

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Looking ahead

Although the claims of consensus we have seen from recent political developments may mark a move towards greater global harmony, financial institutions should carefully monitor developments to ensure these principles are in practice implemented in a way that is manageable in the context of global businesses. We will explore in future editions whether the claims to collaborate are applied in practice.

If you would like to provide feedback on this or other editions, please contact Laura Feldman.