



# GLOBAL ADVOCACY NEWS AND UPDATE

AUGUST 2019

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## FOR COMMENTS OR QUESTIONS, PLEASE CONTACT

Kurt Schacht, CFA,  
Managing Director  
of Advocacy  
[advocacy@cfainstitute.org](mailto:advocacy@cfainstitute.org)

**As summer winds down and we kick off our new fiscal year, we in the Advocacy group are ready for a productive, dynamic year ahead.** As Brexit continues to dominate the news and minds of many in the financial sector, we bring you a brief update on its impact. We also provide overviews of two ESG reports from the Asia Pacific region—and highlights of our recent comment letters that promote transparency and trust in financial reporting and audits, both in Europe and the US. Our usual roundup of media highlights is also included. —**Kurt Schacht, CFA, Managing Director of Advocacy**

## INVESTOR PROTECTION

### BREXIT UPDATE: UNCERTAINTY REMAINS

**UK dissatisfied and divided:** Boris Johnson was elected leader of the UK Conservative Party on 23 July 2019 with a large majority, yet UK citizens remain largely dissatisfied and divided. According to a poll by *Ipsos Mori*, 75% of voters are already dissatisfied with the new government's performance, compared to just 18% who are satisfied. This finding can be largely explained by the lack of progress on Brexit. Polls also suggest that Johnson's appointment as prime minister and the apparently growing likelihood of a no-deal Brexit have added to strains on UK unity. Prime Minister Johnson's recent tensions and disagreements over Brexit with Parliament are also adding to the country's frustration.

**Economic impact:** It is difficult to precisely predict the impact of a no-deal Brexit on the UK economy, but for now it appears grim. The latest report from the Office for National Statistics (August 2019) presented the worst outlook for the UK economy since the final quarter of 2011. Of consequence to foreign exchange markets, the GBP decline has been severe. There is much yet to play out, but the EU 27 may grant an 11th-hour Brexit extension (only if formally requested by the UK government), adding more economic uncertainty.

**Financial services impact:** The impact of a potential no-deal Brexit on financial services generally, and to our CFA members specifically, is also a growing concern. Prime Minister Johnson's strategy for exiting the EU, deal or no deal, represents the worst-case scenario in nearly all financial firms' contingency plans. The actual movement of staff away from London has been so far largely muted, but firms have relocation plans in place and could be simply waiting for the final situation to enact them. Meanwhile, EU institutions have also started preparing for a no-deal Brexit. The comprehensive MoU signed between the European Securities and Markets Authority (ESMA) and the Financial Conduct Authority (FCA) in February 2019 provides relief (maybe temporary) for the delegation of investment management on which much of the current European-UK asset management framework relies; however, it does not answer the question of how UK firms would be able to conduct marketing and distribution in the EU. We will continue to closely follow all Brexit developments.

## ADVOCACY IN ACTION

### MEDIA ATTENTION

*Economia* (28 August): Kazim Razvi, Director of Financial Reporting Policy at CFA Institute, explained why audits aren't meeting investor expectations.

*Pensions & Investments* (27 August) reported on new pension reforms in the UK and mentioned that CFA Institute is currently developing a Fiduciary Management Performance Standard.

*Fortune* (26 August) quoted Kurt Schacht, Managing Director, Advocacy at CFA Institute, on potential Volcker Rule changes.

*Finanz und Wirtschaft* (German print) (26 August) reported on a CFA Institute report indicating MiFID II leads to fewer jobs and less research.

*Hong Kong Economic Journal* (23 August): Mohini Singh, Director of Financial Reporting Policy at CFA Institute, makes the case against semi-annual reporting.

*Bloomberg Tax* (22 August) reported on a CFA Institute letter criticizing the SEC's plan to ease audit rules for banks.

*Investment News* (21 August) reported on a CFA Institute study showing that ESG data has become more mainstream.

*Daily Telegraph* (print) (20 August) included a graph from CFA Institute showing the results of a MiFID II survey.

*ThinkAdvisor* (14 August) reported on a CFA Institute member survey showing little support for semi-annual reporting.

*Financial Planning* (12 August) mentioned a CFA Institute survey on clarity and transparency in fees and expenses.

*Hong Kong Economic Journal* (9 August): Mary Leung, Head of Advocacy, Asia Pacific at CFA Institute, penned an article on dual-class share structures.

*InfoMoney* (BRA) (7 August) refers to CFA Institute's cryptocurrency curriculum.

*Business Ethics* (6 August): Matt Orsagh, Director of Capital Markets Policy at CFA Institute, wrote about how to incorporate ESG into corporate bond analysis.

*Australian Financial Review* (2 August) reported that fund managers see ESG analysis as important, according to a series of industry events run by CFA Institute.

*Pensions & Investments* (5 August) mentioned CFA Institute in an article on Senator Warren's new bill calling for more industry reforms.

*Nasdaq* (5 August): Kurt Schacht, Managing Director, Advocacy at CFA Institute, penned an article on tough questions investors should ask their investment professionals.

*Seeking Alpha* (2 August) refers to a discounted cash-flow analysis formula used by CFA Institute.

### GLOBAL ACTIVITIES AND EVENTS

**CFA Society NY CECL Webinar:** The Financial Reporting Policy Group participated in a webinar, "*Current Expected Credit Loss (CECL) Reporting: What Will Its Effect Be?*" on the impact of the new impairment model on US banks.

**CFA Society UK Lease Webinar:** The Financial Reporting Policy Group contributed to a webinar on the new leasing standard and what investors should pay attention to as the revised financials are released during 2019.

**CFA Society Switzerland International Valuation Standards Council (IVSC) Meeting:** The Financial Reporting Policy Group participated in a meeting of IVSC in Zurich in conjunction with CFA Society of Zurich.

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## MARKET TRANSPARENCY & FAIRNESS

# OPPOSING THE ROLLBACKS OF AUDIT OF INTERNAL CONTROLS

**Weighing in on a proposed SEC rule:** CFA Institute issued a [comment letter](#) regarding the SEC's Proposed Rule, *Amendments to the Accelerated Filer and Large Accelerated Filer Definitions*, which seeks to allow certain companies to be exempted from the current requirement to audit internal controls over financial reporting (ICFR). The new proposal is intended to promote capital formation; but we are not convinced that the rule change will achieve that result, and it may actually weaken investor protections.

**Cost vs. benefits:** In our analysis of the proposed rule, we found several issues regarding the types of companies that will be exempt, as well as uneven cost/benefit effects. Specifically, it appears that the banking industry will benefit the most from the rule change; however, due to its complexities, these are the companies that most need audits of internal controls. The SEC also fails to demonstrate that the benefits will outweigh the costs of increased exemptions. The SEC's cost/benefit analysis focuses more on the cost savings to issuers than it does on the benefits of ICFR attestation to investors. The ICFR costs to be saved are not significant relative to the measures of public float, revenue, or assets of the affected companies. In addition, the potential cost to investors of internal control errors and restatements could easily be multiples of ICFR costs.

**Our position:** CFA Institute supports preserving the current accelerated filer definition. It is important for investors to have high-quality, reliable financial statements to promote trust and confidence in the capital markets. Providing investors with reliable financial statements depends in part on the effectiveness of the controls and safeguards management has over accounting and financial reporting and the audit over the controls.

**Media pickup:** Our letter received media coverage, including in *Bloomberg Tax* and in *Thomson Reuters Tax & Accounting Checkpoint Newsstand* newsletter, which reported, "The CFA Institute said the SEC must reconsider exempting the smaller banks because of the 2008 financial crisis when there was not sufficient focus on asset impairment and the challenges of these banks in implementing Current Expected Credit Losses (CECL). Moreover, the group said internal controls will play an important role in the adoption and audit of CECL model."

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## INVESTOR PROTECTION

# IN SUPPORT OF FAIR VALUE ACCOUNTING

**EFrag public consultation:** CFA Institute submitted a [comment letter](#) to the European Financial Reporting Advisory Group (EFRAG) consultation *Equity Instruments—Research on Measurement*, which explores potential alternative accounting treatments for long-term equity investment, as part of the European Commission's *Sustainable Finance* initiative.

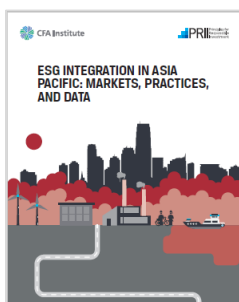
**Our position:** We communicated our long-standing position for fair value accounting as the most relevant and useful accounting basis for investors. As such, we strongly disagree with changing the current IFRS 9 Financial Instruments and IFRS 13 Fair Value to facilitate long-term investment. We believe any reporting changes will be unhelpful to investors. Because investors invest globally, any further divergence would be confusing and increase complexities for both preparers and users of the financial statements. However, should EFRAG press this issue forward with IASB, we believe—at a minimum—an IFRS 13-compliant disclosure to ensure global comparability should be provided to investors.



## PROFESSIONAL PRACTICE

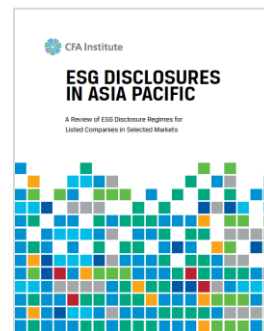
## TWO NEW REPORTS ON ESG IN ASIA PACIFIC

**Guiding ESG integration:** Recognizing the rise in environmental, social, and governance (ESG) integration in investments across the globe, CFA Institute is at the forefront of analyzing this process to provide guidance and best practices. To this end, CFA Institute has released two reports focused on ESG in the Asia Pacific area.



**ESG Integration in Asia Pacific:** In collaboration with Principles for Responsible Investment (PRI), CFA Institute published *ESG Integration and Analysis in Asia Pacific: Markets, Practices and Data*, the fourth publication in a series presenting the current state of ESG integration around the globe. The reports help investors learn how they can better integrate ESG data into their analysis and investment decision making. From the study, we found governance is the factor most investors integrate into their process, with environmental and social factors gaining more and more acceptance. Although there is no one best way to integrate ESG into the investment process, the main drivers are risk management and client demand; and barriers are limited data and understanding of ESG issues. Further improvements in data quality and comparability are needed.

**ESG Disclosures in Asia Pacific:** CFA Institute also released a [new report](#) tracing the evolution and trends in ESG disclosures in seven Asia Pacific markets. The report found that corporate governance reporting is the most common and advanced component, but environmental disclosures have come to the forefront recently and are the chief focus of new disclosure initiatives in Hong Kong SAR and China. Reporting requirements have been growing stricter, with ever more disclosures becoming mandatory. The approach of regulators and exchanges to developing their ESG disclosure regimes varies among markets. Further harmonization and standardization of global frameworks are needed to provide clarity to investors and issuers. One surprising leader in the emerging markets is the Stock Exchange of Thailand, which has successfully fostered an effective ESG disclosure regime—surpassing, all other AP markets in the percentage of listed companies.



**Our position:** The publication of these reports underscores our stance on the importance of integration of material ESG factors into the investment process. We believe that more thorough consideration of ESG factors by financial professionals can improve the fundamental analyses they undertake and ultimately the investment choices they make. ESG disclosures are an important tool that gives investors access to relevant material data. Governments, regulators, and exchanges should ensure meaningful and accurate disclosures, clearly articulate their benefits for issuers, offer guidance, and work toward harmonization of standards.

## MARKET TRANSPARENCY &amp; FAIRNESS

## PROMOTING TRANSPARENCY IN NON-GAAP MEASURES

**In support of CII's petition:** CFA Institute issued a [letter](#) to the SEC in support of the [Council of Institutional Investors \(CII\)'s petition](#) to include reconciliation of non-GAAP measures in compensation discussion and analysis (CD&A). CII requested that the SEC amend certain rules to clarify and coordinate the use of non-GAAP measures in CD&A filings.

**Our position:** We fully agree with the CII petition and the underlying importance of transparency and consistency in using non-GAAP measures. Because investors see the merit in using such measures but are concerned with their potential abuse, it is essential that investors are able to understand and analyze the use and impact of non-GAAP measures on the determination of executive compensation. The CII's petition would facilitate this understanding and ensure the alignment of management's interests and compensation with shareholder's interests and returns.

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## MARKET TRANSPARENCY & FAIRNESS

### WEIGHING IN ON UK AUDIT REFORM

**Commenting on the Brydon Review:** CFA Institute recently [commented](#) on the UK's [Independent Review into the Quality and Effectiveness of Audit Call for Views](#) (also known as the Brydon Review), which is intended to strengthen the quality and effectiveness of audits. This is one of several reviews of the UK audit market under way in response to recent high-profile audit failures.

**Importance of audit quality:** In our response, we emphasized the importance of audit quality globally and put forth numerous examples of previous calls for audit reform and improving audit quality. We believe audit quality is the single most important area that needs significant improvements both relating to the audit process and product and the related regulation. Our [letter](#) responded directly to the 60 specific questions in the Brydon Review, providing overarching considerations and highlighting issues with the consultation that might make interpreting the results challenging. Overall, we encouraged the Brydon Review to properly define audit quality perception gaps and to prioritize findings.

**Our position:** An integral part of promoting fair and transparent global capital markets and investor protections is ensuring that corporate financial reporting and disclosures—and the related audits—provided to investors and other end users are of high quality. CFA Institute has a long history of advocating for audit reforms globally, including, most recently, reforms to enhance the auditor's report and to increase transparency regarding audit participants; and we have also called for audits of internal controls and auditor oversight reforms.

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## PROFESSIONAL PRACTICE

### MAKING A SAVVIER FINANCIAL CONSUMER

**Published in [Nasdaq](#):** In the context of the newly passed “so-called” SEC Regulation Best Interest (Reg BI), CFA Institute recommends investors arm themselves with a series of questions and a savvy shopper mindset. The new Reg BI rule, which was intended to ensure that brokers are working in their clients' best interests, falls short of its name. Instead of protecting investors, it establishes a buyer-beware system in disguise. Investors need to be prepared with specific information and a critical mindset, similar to a consumer buying a new car, to protect themselves.



**Tough questions to ask investment professionals:** To help navigate the important financial planning process, investors should keep several important, incisive questions for a prospective investment professional handy, including what the title “adviser” means, what potential conflicts of interest may exist, what fees or costs are involved, and how professionals are compensated. By asking the right questions and shopping around, investors will hold financial advisers to a higher standard and ultimately be smarter financial consumers.