Happy new year! At CFA Institute, we are off to a productive start and are pleased to share some important updates on our efforts in advocacy around the world. In this issue, we provide highlights of several important new reports, including the just-released examination of ETFs and their association with systemic risk, as well as a report on initial coin offering regulation in France that should serve as a case study for the rest of Europe. You'll also find an update on US Congress’s recent hearing on the controversial new financial instruments impairment model called CECL and what it means for investors. As usual, we provide a summary of our media coverage and global events.

—Kurt N. Schacht J.D., CFA, CFA Institute Policy Director, Washington D.C.

EXAMINING ETFS AND SYSTEMIC RISKS

New report: CFA Institute has published an important deep dive into exchange-traded funds (ETFs), shedding light on their impact on systemic risks in the financial markets. Since their introduction nearly 30 years ago, ETFs have revolutionized asset markets by using an innovative structure to make investing in a wide variety of asset classes simpler and cheaper. ETFs have experienced spectacular growth but also are associated with recent episodes of market instability. This report examines whether ETFs are actively involved in destabilizing market dynamics, or whether they are merely innocent bystanders in today’s complex market environment.

Pros versus cons: This paper reviews current research on these issues and analyzes both the key benefits of ETFs and the potential systemic risks posed by ETFs, and why they might arise. Among the issues considered are the impacts of ETFs on market close, the problems raised by underlying asset illiquidity, market concentration at various levels of the ETF food chain, and risks from authorized participants. We draw attention to some emerging risks such as those arising from the increased use of ETFs as cash substitutes.

Regulatory oversight: We conclude that ETFs can be a source of systemic risk, in large part, because these assets can induce important feedback effects in markets. We also conclude that these effects can be greatly mitigated by careful regulatory oversight. Securities and prudential regulators need to have a better understanding of the potential magnitude of the issues related to ETFs, and how they can address them in the future. We identify a variety of actions that can be taken to keep the risks under control. One takeaway is the need to collect and disseminate information on the number of entities using ETFs as cash equivalents, and the magnitude of these exposures. Regulators also may need to boost reporting about underlying markets, particularly for funds tracking illiquid and opaque markets.
MEDIA ATTENTION

*Hong Kong Economic Journal* (11 January): Eugene Hsiao, Senior Manager of Capital Markets Policy at CFA Institute, APAC, wrote about WeWork’s failed IPO. “From the perspective of corporate governance and investor protection, the disaster of WeWork’s initial public offering (IPO) will be a warning story,” according to Hsiao.

*Business Times* (SGP) (9 January) reported on a CFA Institute study showing that ending quarterly reporting is not effective in battling short-termism.

*Hong Kong Economic Journal* (9 January) cited a CFA Institute survey indicating ESG’s continued growth into 2020.

*The Globe and Mail* (CAN) (7 January) referred to CFA Institute as currently “convening a working group to define the scope and nature of ESG standards, including screening criteria, scoring models and benchmarks.”

*Top1000Funds* (7 January): Eugene Hsiao, Senior Manager of Capital Markets Policy at CFA Institute, APAC, wrote about dual-class shares.

*BloombergTax* (6 January) quoted Kazim Razvi, Director of Financial Reporting at CFA Institute, about reports that the SEC is considering updating its requirements on accounting for supply chain financing.

*Business Times* (SGP) (3 January): Matt Orsagh, Director of Capital Markets Policy at CFA Institute, wrote about ESG integration.

*ThomsonReuters* (3 January) quoted Sandra Peters, Senior Head for Global Financial Reporting Policy at CFA Institute, about concern over the SEC’s plan to establish a “human capital” disclosure requirement.

*Business Ethics* (22 December): Matt Orsagh, Director of Capital Markets Policy at CFA Institute, discussed integration of ESG measures into municipal credit analysis.

*Chief Investment Officer* (22 December) cited a CFA Institute report indicating that SRI investing and Islamic finance are “two sides of the same investment coin.”

*The Asset* (HKG) (20 December) cited a CFA Institute report showing increased demand for ESG information.

GLOBAL EVENTS & ACTIVITIES

**Roundtable on the State of ESG Disclosures in India: Regulations and Best Practices**, Mumbai, India, 10 January 2020: Sara Cheng, Senior Director of Capital Markets Policy and Strategy at CFA Institute, APAC, participated in an industry event focused on key ESG issues in India held at the National Stock Exchange. She outlined ESG disclosure regimes across select markets in Asia Pacific, based on a CFA Institute report. The roundtable was attended by regulators, industry practitioners, and CFA Society members and featured a keynote speech from Dr. Yilmaz Arguden, a renowned corporate governance expert and the chairman of ARGE Consulting.

**IOSCO Affiliate Members Consultative Committee (AMCC) Mid-Year Meeting and Training Seminar**, Madrid, Spain, 2–3 December 2019: Josina Kamerling, Head of Regulatory Outreach at CFA Institute, EMEA, participated in the IOSCO AMCC event. She led a training seminar on “Ethics and Innovation in the New Era of Financial Services,” focused on business conduct and the future challenges brought by innovation.

**CFA Ireland Regulatory Event**, Dublin, Ireland, 11 November 2019: Jim Allen, Head of Capital Markets Policy at CFA Institute, Americas, spoke to society leaders on the regulatory climate in the US at a CFA Ireland event. The discussion covered a number of current regulatory proposals and an assessment of the newly adopted Regulation Best Interest and Form Customer Relationship Summary rules.

**Proxy Voting Task Force**: CFA Institute is a participant on an industry task force considering ways to improve proxy voting mechanics and technology with a goal toward improving the accuracy of proxy voting. The task force is looking to ensure that institutional investors have an efficient means of voting their shares on behalf of beneficial owners, and to ensure that all shareowners have the opportunity to vote their shares in company elections.
MARKET INTEGRITY & TRANSPARENCY

CECL ON THE CONGRESSIONAL HOT SEAT

Congressional hearing: Financial Accounting Standards Board (FASB) Chair Russ Golden and Public Company Accounting Oversight Board (PCAOB) Chair William Duhnke were called before the U.S. House of Representatives Committee on Finance Services (Committee on Investor Protection, Entrepreneurship, and Capital Markets) on 15 January 2020. The main focus of the hearing was to probe the controversial new financial instruments impairment model, referred to as the CECL (cumulative expected credit loss) model. CECL requires the estimation and recognition of an expected credit loss as of the inception date of a new loan. This has created concern among lawmakers of both political parties that the model would reduce loans to many customers and diminish economic growth. Despite an effective date of 1 January 2020 for public companies, Congress persists in its efforts to block the standard, claiming faulty economic impact analysis and harm to consumer lending.

Our position: CFA Institute communicated numerous times over the past decade that investors prefer fair value rather than an upfront impairment “guess.” We consider the CECL model as too subjective and inferior to our long-held view of fair value measurement. As CFA Institute has stated before, industry claims of “procyclical” is the new synonym for “I don’t like the accounting result,” Likewise, we have cautioned repeatedly about political pressure in the setting of accounting standards. It destroys the independence of the FASB process and negates decades’ worth of advancement on fair and consistent due process in financial reporting standards-setting.

MARKET INTEGRITY & TRANSPARENCY

AN EARLY LOOK AT ICO REGULATION IN THE EU

New report: In partnership with CFA Society France, CFA Institute released a policy research report, Initial Coin Offerings—Too Soon or Too Late?, which provides an important analysis of the newly enacted French regulatory approach to initial coin offerings (ICO), introduced in 2019. The piece looks at the recent developments of the ICO and crypto asset market and reviews Autorité des Marchés Financiers’s (AMF) attempt to regulate ICOs in France, the first of its kind in the EU. Highlighting both the challenges and positives that policymakers are encountering, this report is a deep-dive case study with lessons for the rest of Europe. This research also examines the accounting issues posed by these ICOs as well as potential environmental issues, pointing to a looming clash between the fintech and sustainable finance regulatory agendas.

Our position: CFA Institute supports technical innovation in financial services—however, not at the expense of market integrity and fairness, or investor protection. As a result, we have several reservations about the regulator AMF’s recent attempt at creating a regulated ICO market in France. First, the proposed information document that the AMF requires for ICO approval does not demand the disclosure of any financial information. We also believe that current requirements for technical disclosures are insufficient, particularly in regard to the underlying smart contract functionality of the ICO. The importance of post-ICO secondary market trading has been underestimated or overlooked, and it is mostly absent from the new ICO regulatory framework. Lastly, we believe that an opportunity has been missed to integrate the EU’s sustainable finance agenda into the fintech space. We predict that this issue will intersect with ICOs and other crypto assets in the near future as recognition of their outsize energy consumption spreads.
INVESTOR PROTECTION

FINDING INVESTOR DISAGREEMENT WITH PROPOSED AMENDMENTS TO FEFTA

New survey: On 16 December 2019, CFA Institute and CFA Society Japan published the results of a survey that assesses investors’ views on the proposed amendment to Japan’s Foreign Exchange and Foreign Trade Act (FEFTA). The amendment, which was proposed by the Ministry of Finance on 8 October, lowers the ownership threshold in companies deemed to be nationally sensitive from 10% to 1% before government preapproval is required for foreign shareholders.

Majority disagree: Given the importance of this amendment to the investor community both in Japan and internationally, CFA Society Japan and CFA Institute conducted a survey of professionals in the investment industry in order to understand their positions and concerns on the amendment. The results show that a large majority (nearly 70%) of respondents do not agree with the amendment, and 86% are concerned that the amendment might have a negative impact on investment into the Japanese equity market.

MARKET INTEGRITY & TRANSPARENCY

SEC CONSIDERS SHAREOWNER PROPOSAL THRESHOLDS

SEC proposal: The SEC issued a consultation on a change to the rule that governs the process for shareholder proposals to be included in a company’s proxy statement. This rule requires most publicly traded companies to include shareholder proposals, subject to certain ownership restrictions, in their proxy statements. The SEC is considering whether to raise the thresholds for inclusion of shareowner proposals in company-published proxy reports in the years after the proposals were first submitted. Specifically, it considers raising the resubmission thresholds to 5% approval in the first year after submission (from 3%), to 10% approval in year 2 (from 6%), and to 15% in year 3 (from 9%). It also would permit companies to exclude proposals when shareowner support had declined from year to year. Submitting shareowners also would have to meet with company executives prior to their proposals’ inclusion in the proxy.

Our position: One of our primary concerns is the increase in thresholds for resubmission of prior shareowner resolutions that didn’t reach majority approval. The higher thresholds are important because it could prevent the launch of improvements to the governance process, in the same way that prior votes on elimination of staggered boards, majority voting for board directors, and say on executive pay all paved the way toward better governance practices and enhanced communication between shareowners and companies.

NEW MEMBER OF SYSTEMIC RISK COUNCIL

Jeremy Stein, Chairman of the Department of Economics at Harvard University and former member of the Board of Governors of the Federal Reserve System, joined the Systemic Risk Council (SRC). Stein is a fellow of the American Academy of Arts and Sciences, a research associate at the National Bureau of Economic Research, and a member of the Federal Reserve Bank of New York’s Financial Advisory Roundtable. He also served as president of the American Finance Association, as a senior advisor to the Secretary of the Treasury, and on the staff of the National Economic Council.

SRC Chair Paul Tucker said, “I am absolutely delighted that Jeremy Stein is joining the Systemic Risk Council. A front-rank economist and seasoned policymaker, committed to maintaining financial stability, Jeremy enriches our ranks as we strive to keep the authorities focused on doing more to avoid financial crises and instability.”

The SRC is supported by CFA Institute to monitor and encourage regulatory reform of US capital markets focused on systemic risk.