ADVOCACY UPDATE

GLOBAL ADVOCACY NEWS AND UPDATE

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IN THIS ISSUE

FOR COMMENTS OR QUESTIONS, CONTACT

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As the financial industry grapples with January's market debacle surrounding GameStop, we provide updates on the latest response from the Systemic Risk Council (SRC) and highlights from a CFA Institute–hosted event. This issue features a review of our recent advocacy on goodwill accounting, as well as a thorough examination of the EU's likely regulatory developments for the coming year. As always, we provide news on our advocacy in action, including key appointments, events, and media coverage.

INVESTOR PROTECTION

SYSTEMIC RISK COUNCIL URGES CONGRESS TO DEFEND MARKET FRAGILITIES

Urging stability: In the wake of the GameStop market volatility, the Systemic Risk Council (SRC), a CFA Institute initiative, issued a letter to the US Congress to recommend that specific financial issues be addressed to ensure the resilience and stability of the financial system. Key areas of concern include the following:

- **Collateral requirements and the systemic role of clearinghouses:** Given the abrupt market halt, Congress should examine whether clearinghouse collateral requirements were too low and their actions to trigger additional collateral were too slow as well as whether the protocols and processes were fit to cope with the situation.
- **Capital requirements for US broker/dealers:** Congress should examine whether SEC equity requirements are properly calibrated against the kind of volatility and the degrees of leverage that characterize modern markets.
- **The re-hypothecation of collateral:** Given the degree of leverage associated with re-hypothecation (or re-pledging collateral on a debt) chains, Congress should reexamine whether the procedure should be barred or whether it warrants higher collateral requirements.
- **Complacency about easy monetary policy's effects on financial market exuberance:** Congress should explore what can be done to constrain excessive leverage in a range of capital markets, including raising minimum collateral in certain capital markets.

Ensuring stability: Paul Tucker, chair of the SRC, said: "While the recent equity market kerfuffle was not a direct threat to stability, the authorities must energetically learn from an ugly episode involving a scramble for collateral, to close out positions, and to cut off services. Congress should ensure the unfinished business of rebuilding the financial system's resilience resumes." The SRC is a nonpartisan body of former government officials and financial and legal experts committed to addressing regulatory and structural issues relating to global systemic risk, founded and sponsored by CFA Institute.

MARKET INTEGRITY & TRANSPARENCY

GOODWILL: TO AMORTIZE OR NOT?

Coordinating standards: In February, the International Organization of Securities Commissions (IOSCO) issued its *Statement on Enhancing Collaboration between the IASB and the FASB on Accounting for Goodwill*, calling for the International Accounting Standards Boards (IASB) and Financial Accounting Standards Board (FASB) to work together on individual projects analyzing whether the accounting for goodwill should be changed. Currently, goodwill is recognized upon a company's acquisition of a business and is reduced only upon determination that it has been impaired. Research has shown, however, and many investors have long believed, that the market recognizes the impairment of goodwill long before company management takes the charge.

Our position: CFA Institute has provided consistent, ongoing guidance on this issue, including a December 2020 comment letter on the IASB's consultation document *Business Combinations—Disclosures, Goodwill and Impairment*, and a comment letter to the FASB's 2019 consultation *Identifiable Intangible Assets and Subsequent Accounting for Goodwill*. We concur with IOSCO that global convergence from the FASB and IASB in the areas of goodwill accounting, impairment testing, and related disclosures is essential for investors. We also believe that improving disclosures regarding the initial recognition and valuation of goodwill and intangibles and the related impairment testing would be the most useful first step in evaluating a way forward before making a change to the accounting.

Initial different directions: CFA Institute has highlighted our concern that the FASB is heading toward a model in which companies will be allowed to amortize goodwill over a period of 10 years. The FASB has indicated they will continue to overlay amortization with an impairment assessment, but the reality is that amortization is an accounting mechanical cure (time-based write-off) for bad impairment testing. Impairment will only worsen under an amortization model as management will allow time to take care of reducing goodwill balances. The IASB, on the other hand, has proposed an approach in which the existing impairment model will be retained but improved with disclosures that will enable investors to ascertain whether acquisitions are successful relative to strategic objectives made by management and the board at the time of acquisition.

Significant impact: Investors should pay attention to this debate as a decision by the FASB to amortize, compared with IASB's approach to improve disclosures, will have a drastic impact on comparability on balance sheets and income statements globally. Given the large amount of goodwill currently on the books ($3.3 trillion for US public companies, representing 32% of total equity, and $5.6 trillion for S&P 500, at 41% of equity, in 2018), the difference in accounting would result in a dramatic difference in comparability.

CFA Institute Appoints New Managing Director to Leadership Team

CFA Institute welcomes Paul Andrews to our leadership team as managing director of Research, Advocacy, and Standards, effective 1 March 2021. Andrews most recently was the secretary general of the International Organization of Securities Commissions (IOSCO) and has 25 years of experience in leadership positions at the forefront of national and international financial regulation. In his new role, he will oversee the strategic direction and leadership of the Research, Advocacy, and Standards function to position CFA Institute as an innovator and thought leader in investment management. Andrews's deep expertise in the regulatory environment—working with government agencies, businesses, international regulators, and other organizations—will enable CFA Institute to promote investor protection, best practices, standards, and education in the investment management industry.

Proper cost versus benefit analysis needed: CFA Institute has significant concerns with the FASB's assertion that impairment testing is costly, as they have not actually studied or gathered any hard data on the cost of impairment testing. Clearly, such an important decision as reverting to amortization should not be made without a transparent cost-benefit analysis.

Early glimpse on member views: In November 2020, CFA Institute surveyed its members about the initial recognition and subsequent measurement of goodwill accounting. Early results showed that nearly 90% of respondents agree or strongly agree that the IASB and FASB should follow the same approach in goodwill measurement. More results and a final report will be released soon.

INVESTOR PROTECTION

MAKING SENSE OF THE GAMESTOP SAGA

CFA Institute webinar on GameStop episode: On 11 March, Kurt Schacht, CFA Institute policy director, led a panel discussion during a CFA Institute webinar, "*Retail Investors Go Viral: Market and Policy Implications Stemming from the GameStop Stock Trading Mania*." The panel of market experts and Washington insiders included John Coffee, securities law expert and Columbia Law professor; Brad Bennett, former head of Financial Industry Regulatory Authority enforcement; and Milan Dalal, former staff director for Senate Banking subcommittees and a senior economic adviser to Sen. Mark Warner (D-VA).

Urgent topics: The panel examined relevant, timely issues, including whether recent market volatility was driven by market manipulation; volatility catalysts, such as the mobilization of social media, the rise of retail investing, and frictionless trading; the impact of these developments on market plumbing; and the legislative and regulatory policy outlook.

Our position: CFA Institute continues to emphasize that while the markets withstood the January volatility, further examination of market infrastructure and measures to protect retail investors is necessary. We encourage policy makers to ensure investor trust in markets, information integrity, and robust disclosure and transparency.

Key industry issues: The webinar also covered the ongoing industry discussion on shortening the settlement cycle, options trading by notice retail investors, best execution under payment for order flow, capital adequacy rules, and disclosure of short positions. More than 250 CFA Institute members, congressional staff, regulators, and investment professionals from around the world tuned in to the webinar, and more than 600 registrants are expected to view the recording, available until 10 April 2021.

MARKET INTEGRITY & TRANSPARENCY

SYSTEMIC RISKS AND CLIMATE CHANGE: ARE CENTRAL BANKERS PREPARED?

Urging risk mitigation: Now is the time for financial regulators around world to focus on and proactively tackle the financial stability risks associated with climate change. Sheila Bair, founding chair of the Systemic Risk Council, a CFA Institute initiative, explained: "While federal agencies must maintain appropriate boundaries between environmental policy and financial regulation, they should identify and mitigate such growing risk to the financial system from environmental threats. Volatile weather, rising sea levels, and often intensifying natural disasters impact financial institutions from their exposures to affected households and businesses as well as the collateral damage," said Bair. She suggested that regulators need to focus on several key areas to prevent financial losses and harm to the economy, including the following:

- A clear global approach to corporate sustainability reporting, including better disclosure frameworks to report material climate trends and corporate decisions to mitigate threats.
- A coordinated global effort to accurately measure emerging financial threats associated with climate change, including assessment of risk across borders and all segments of the financial system (i.e., banking, insurance, pensions, and other investments).

Act now: Bair explained, "All financial regulators, both individually and collectively in the Financial Stability Oversight Council, must emerge from the sidelines and confront the interplay of finance and climate change. . . . This should include a full assessment of the effects of a serious climate disruption and the odds of steep market losses as well as any serious insurance underwriting losses." The financial system will not remain immune to the inevitable economic losses resulting from climate change. The time to act is now (see the full article in *The Hill*).

MARKET INTEGRITY & TRANSPARENCY

INSIDE THE EU'S POLICY-MAKING MACHINE

EU's transformational regulatory developments: The EU faces significant challenges in the year ahead, navigating the first year of post-Brexit issues, along with the ongoing Covid-19 crisis. In this environment, the EU is determined to enact a large number of policy and regulatory changes that will have a profound impact on the investment management industry. CFA Institute, in collaboration with local CFA Societies, will be monitoring and analyzing all developments to ensure that market integrity and transparency, investor protection, and industry professionalism are upheld.

Post-Brexit context: EU leaders want to set the post-Brexit Union on a course to global leadership in completing a capital markets and banking union and creating a green and digital economy by quickly establishing global standards. At the same time, the EU is focused on developing an open strategic autonomy trade policy, with a higher capacity to rely on its internal market for strategic needs, while still depending on an open architecture model with its international trading partners. The EU Commission has recognized the importance of fostering an EU financial sector that could allow for various financial centers to develop and grow different competencies, within a single market.

Key priorities: Among the priorities set by the current Portuguese presidency of the Council of the European Union, CFA Institute is primarily focused on the following: (1) the completion of the banking union and the Capital Markets Union (CMU); (2) the transition to a green economy; and (3) the digitization of finance.

- **CMU completion:** Successfully accomplishing the CMU means, in large part, coordinating the various regulatory frameworks that deal with investment products and financial markets, including the Markets in Financial Instruments Directive (MiFID II; markets and investment management), Undertakings for Collective Investment in Transferable Securities Directive (UCITS; retail funds), Alternative Investment Fund Managers Directive (AIFMD), packaged retail investment and insurance-based products (PRIIPs; key information documents for investors), European long-term investment funds (ELTIFs), and the pan-European personal pension product (PEPP). The major challenges of this complex system include the diversity in EU directives across member states, misaligned definitions between regulatory frameworks, and a lack of supervisory convergence, resulting in a matrix of varying rules throughout the EU on product governance, suitability checks, client categorization, marketing and distribution, and reporting. Other significant issues facing the EU include balancing small and midsize enterprises (SMEs) and pension funding, post-pandemic recovery, and long-term savings. This year will see many regulatory reviews aimed at addressing these matters.

- **Green transition:** The EU's overarching sustainability objective requires a comprehensive rethinking of the financial system to reorient private capital to more sustainable investments to develop growth, stability, transparency, and long-termism in the economy. Three recent complex, and sometimes inconsistent, regulatory efforts include the EU Taxonomy of sustainable economic activities in 2020, the Non-Financial Reporting Directive (NFRD) for company accounts in 2014, and the Regulation on Sustainability-Related Disclosure in the Financial Services Sector (SFDR) in 2019. Challenges in coordinating these rules range from operational complexity, and varying political and regional definitions of acceptable sustainable activities, to a lack of harmonized and verifiable sources of data, and unequal regulatory enforcement among member states. Sustainable corporate governance and broader stakeholder considerations in company governance are rising concerns. These frameworks are being reviewed or getting technical standards in 2021.

- **Finance digitization:** The EU Commission adopted a Digital Finance Package in September 2020, which aims to facilitate new forms of capital funding to SMEs, while maintaining consumer protection and financial stability. Clearly, the objective favors the emergence of an EU market for crypto assets, and a design of proper regulations for the field, including for cybersecurity risks (operational resilience). At a technical level, it intends to make use of distributed ledger technology (e.g., blockchain) to create, safeguard, and control transactions. Strategically, the EU wants digital finance to unblock new financing mechanisms and economic opportunities for the green transition. Legislation will gradually be proposed around this package.

ADVOCACY IN ACTION

IMPACT METRICS

CFA Institute Asia Pacific Research Exchange (ARX) Highlights

ARX is a research hub that brings together like-minded stakeholders in the finance and investment management industry to share, learn, and engage on industry topics and trends specific to the Asia-Pacific region.

Key updates first half FY2021 (9 January to 28 February 2021):

- **Views and visitors:** 23,500 page views; 12,000 unique visitors (monthly average)
- **ARX-branded events:** 37 events; 10,421 event registrations (nearly 50% members)
- **ARX content:** 462 posts; 4,230 pieces of content
- **Society volunteer interest groups:** ESG, FinTech, Student Corner, Islamic Finance
- **New thematic pages:** Covid-19, ESG, FinTech, Student Corner
- **Top markets for content viewers:** United States, Bangladesh, India, Hong Kong SAR
- **New partnership:** Collaborating with HKEX on green and sustainable finance
- **Awards:** Awarded the Financial Education Champion award from the Investor and Financial Education Council (subsidiary of the SFC) and the Industry Association of the Year award from Regulation Asia

MEDIA ATTENTION

Morning Consult (17 March): CFA Institute President Margaret Franklin discussed Congress's GameStop hearings and recommended action.

Financial Times, *Pensions & Investments* (4 March) covered the SRC calls on Congress to examine the GameStop controversy.

Asia Asset Management (25 February): CFA Institute Asia Pacific Head of Advocacy Mary Leung discussed the need for stewardship code awareness in Asia.

The Hill (25 February): SRC Founding Chair Sheila Bair wrote on the urgent need for financial regulators to help combat climate change.

Financial Times (25 February) cited the CFA Institute view on short-termism's cost for business.

Hong Kong Economic Journal (25 February): CFA Institute Asia Pacific Head of Industry Advocacy Mary Leung discussed the importance of the Code of Responsibility in corporate governance in the region.

investESG (23 February) quoted Josina Kamerling, head of Regulatory Outreach, EMEA at CFA Institute, on the need for improved corporate governance in the EU.

EVENTS & ACTIVITIES

Green, Social, and Sustainability Bonds (2 March): Mary Leung, head of advocacy for Asia Pacific at CFA Institute, hosted and moderated a webinar, the third in the ESG in Credit series, organized by CFA Institute with Fitch Ratings. The event focused on the outlook for the green, social, and sustainability (GSS) bond market in Asia Pacific, opportunities and challenges for investors, the risk of "greenwashing," and regulatory developments.

ESG Performance in Tropical Forestry (26 February): Asia-Pacific Research Exchange (ARX), in collaboration with CFA Society Malaysia and the Zoological Society of London (ZSL), presented a webinar focused on sustainable finance in the timber and pulp sector in Asia Pacific, and how financial professionals integrate ESG information in their practice.

What Investors Need to Know about Audits (23 February): Mohini Singh, director, Financial Reporting Policy at CFA Institute, spoke at a CFA Society New York event focused on what we have learned from the recent reporting on critical audit matters (CAMs), including what CAMs are, how this investor-led requirement came into place, and the variety of ways investors can use the information provided by CAMs.

Impact Investing (22 February): Piotr Zembrowski, manager of advocacy research and content for Asia Pacific at CFA Institute, hosted and moderated the webinar "The Future Trends of Impact Investing in Asia." This webinar was the first in a planned series of events on impact investing. It introduced the concept of balancing social and environmental impact goals with financial return, the process and techniques of measuring the impact of an investment, and the risks associated with this approach.