# QUARTERLY SYSTEMIC REPORT

April 2022

## INSIDE



**CFA Institute Systemic Risk Council (SRC or the Council)** is a private sector, nonpartisan body of former government officials and financial and legal experts committed to addressing regulatory and structural issues relating to global systemic risk, with a particular focus on the United States and Europe. It was formed to provide a strong, independent voice for reforms that are necessary to protect the public from financial instability. The goal is to help ensure a financial system in which we can all have confidence.


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**Welcome to the spring edition of the *Quarterly Systemic Report*!** Each quarter, we will recap the activities of the **CFA Institute Systemic Risk Council (SRC or the Council)** and highlight the key systemic debates and challenges affecting global markets and regulators. We find ourselves in unprecedented times both in terms of quantity and frequency of major financial disruptions that test the resiliency of our global financial systems. The private sector Council represents an independent, noncommercial voice on matters of growing and urgent systemic concern. We provide an expert and clear assessment of the readiness of our regulatory institutions to deal with evolving systemic vulnerabilities and advocate for prompt action when improvements in detecting, monitoring, and responsiveness are needed to meet systemic risk threats.

We welcome your feedback -- and look forward to keeping you informed of the key economic twists and turns affecting the resilience and stability of the global economy.

*SRC Updates*

## NEW COUNCIL CO-CHAIRS PROVIDE GLOBAL, INDEPENDENT DIRECTION

**New leadership:** As part of its recent reorganization, the Council now features two co-chairs to cover the two primary regions of activity: Simon Johnson as Co-chair for the United States and Erkki Liikanen as Co-chair for the Euro area. "We are excited and honored to carry on the Council's work and to emphasize our commitment to a clear, trusted and independent voice on needed systemic oversight. This is particularly true as issues like the global pandemic, climate change, and crypto currency bring new challenges to global economic stability," noted Johnson and Liikanen.

**Simon Johnson** is the Kurtz Professor of Entrepreneurship and Professor of Global Economics and Management at the MIT Sloan School of Management. He is a former member of the Congressional Budget Office's Panel of Economic Advisers and previously served as the International Monetary Fund's Economic Counselor (chief economist) in March 2007.

**Erkki Liikanen** is chair of the International Financial Reporting Standards Foundation Board of Trustees. He was a two-term governor of the Bank of Finland and served on the Governing Council of the European Central Bank from 2004 to 2018. Mr. Liikanen has had an extensive career in public service, including two terms as a commissioner of the European Union and service as Finland's ambassador to the European Union.

# COMMENT LETTER: SRC URGES REGULATORY ACTION ON STABLECOINS

**Comment letter:** In February 2022, the Council issued a letter to Treasury Secretary Janet Yellen and members of the Financial Stability Oversight Council (FSOC) urging the group to act on growing risks to US financial stability posed by unregulated stablecoins. The President's Working Group along with other agencies recently released a report recommending that Congress address these risks by passing new legislation that would impose needed regulations on stablecoin issuers and the stablecoin market.

**Needed federal framework:** "We agree with this report that a legislative response would help mitigate threats posed by unregulated stablecoins," said SRC Cochair Simon Johnson. "We also worry there is a significant chance that Congress will not act in time," he added. Given the uncertainties and delays involved in the legislative process, the SRC letter urges policymakers to simultaneously pursue the other proposed routes.

**Dual approach:** The SRC letter recommends a two-pronged strategy that includes FSOC moving quickly to designate stablecoins as systemically important payment, clearing, and settlement activities and, at the same time, asking each of the FSOC member agencies, including the banking regulators, the U.S. Securities and Exchange Commission (SEC), the Commodity Futures Trading Commission (CFTC), and the Consumer Financial Protection Bureau (CFPB), to use their existing authorities to regulate stablecoins. For more information, see the full letter.

# COMMENT LETTER: MONEY MARKET REFORMS—THIRD TIME'S A CHARM?

**Support for new proposed framework:** In the category of let's fix it once and for all, the SEC recently proposed its third set of proposals in recent years to reform rules and address lingering systemic risks associated with Money Market Funds (MMF). The Council submitted its comment letter on April 15 to reiterate its previous support for ensuring that the rules are properly calibrated to manage panic redemptions or other "runs" on the MMF sector, to shore up potential systemic vulnerabilities, and to further internalize costs imposed by money funds when disruptions arise.

**Key points:** The Council's comment letter emphasized two important areas. The first proritity was on increasing the MMF liquidity rules in a way that will meaningfully enhance the ability of such funds to manage rapid investor redemptions and to make such runs less likely in the first place. Second, the Council supported the SEC's proposal to replace redemption gates and fees with a tool known as swing pricing. The comment letter noted that even with floating net asset value (NAV), early redeemers are still able to shift costs to nonredeemers. Swing pricing is complex but offers what the Council calls enhanced floating NAV and will help the SEC with its goals of establishing a statutory MMF scheme that drives market participants to better organize their MMF investment companies.

**Now is the time:** Moreover, the Council asserts that government bailouts or special Federal Reserve support facilities should be a thing of the past. Since the Great Financial Crisis (GFC) of 2008 and more recently the global response to the pandemic, systemic risk disruptions are no longer remote or rare considerations. These plights are occurring all too frequently and each time are causing specific disruptions in the MMF sector. The Council supports these significant, long-awaited reforms to enhance market resilience and reduce the likelihood of damaging financial panics.

**More information**: For more information, please visit https://www.systemicriskcouncil.org/2022/04/cfa-institute-systemic-risk-council-writes-in-support-of-the-us-sec-proposed-rules-for-money-market-funds/.

 

# CLIMATE CHANGE: FOCUS ON CLIMATE AND SYSTEMIC RISK EFFECTS

**Growing importance:** As the urgency of the climate crisis continues to grow, the Council has been meeting with various experts to discuss how the effects of climate change will affect global economics and systemic risk. The implications of climate change have continued to move up on the agendas of central banks and policymakers for a decade. Now, more formal efforts at creating corporate sustainability reporting standards and regulation of carbon emissions have taken center stage.

**Nonpolitical Council priority**: Over the past 15 years, since the GFC and the recent global pandemic, systemic risk disruptions are no longer rare, isolated events. With climate change looming as an obvious consideration, these far-reaching global strains are now occuring with regularity. While the related politics remain deeply divided in the United States, there is a growing case that the "greening" of the financial system is more about financial stability than advancing a political agenda. The Council understands that factions differ greatly on this point, but it also recognizes that climate change will not wait for political clarity. We plan to a be persistent voice for action as both the physical and carbon transition risks of climate change descend on global markets. Most important, the Council will be an advocate for the careful design of sustainability reporting and climate regulation based on consistent and accurate data.

# SUSTAINABILITY REPORTING: NEW CLIMATE REPORTING PROPOSALS FOR PUBLIC COMPANIES

**Weighing in on climate proposals:** The Council is reviewing the latest approaches being proposed for formal corporate reporting on climate as well as on other potential environmental, social, and governance (ESG) matters. Our last Council discussion underscored the importance of having a consistent, comparable, and reliable approach to how companies report on these matters to more fully assessing climate change developments. The global debate on whether and how such information should be disclosed is intensifying as the demand for such disclosures grows as well.

**International Sustainability Standards Board (ISSB) Proposals:** The ISSB, established at the 2021 United Nations Climate Change Conference (COP26) to develop a comprehensive global baseline of sustainability disclosures for the capital markets, launched a consultation on its first two proposed standards. The ISSB proposes issuing two IFRS Sustainability Disclosure Standards that would require a company to disclose information that enables investors to assess the effect of significant sustainability-related risks and opportunities on its enterprise value and would establish disclosure requirements specific to climate-related risks and opportunities. The deadline for comments is July 29, 2022.

- IFRS S1 General Requirements for Disclosure of Sustainability-Related Financial Information: This standard sets out the core content for sustainability-related financial disclosures, establishing a baseline of sustainability-related financial information.
- IFRS S2 Climate-Related Disclosures: The standard sets out the requirements for identifying, measuring, and disclosing climate-related risks for public companies.

**SEC Proposal:** The SEC released its proposal, "The Enhancement and Standardization of Climate-Related Disclosures for Investors," that would require registrants to provide certain climate-related information in their registration statements and annual reports, including climate-related risks likely to have material impact on iits business, greenhouse gas emissions, and other financial metrics. Comments are due June 2022.

**European Union Sustainability Reporting Standards**: EU law requires certain large companies to disclose information on the way they operate and manage social and environmental challenges. On April 21, 2021, the Commission adopted a proposal for a Corporate Sustainability Reporting Directive (CSRD), which would amend the existing reporting requirements of the Non-financial Reporting Directive (NFRD). The Commission's proposal for a CSRD envisages the adoption of EU sustainability reporting standards. The draft standards would be developed by the European Financial Reporting Advisory Group (EFRAG).

 

*SRC in Action*

# GLOBAL CONFLICT: UKRAINE CONFLICT IMPLICATIONS FOR SYSTEMIC RISK

**Urgent debriefing**: A special meeting of the Council convened on March 11 to discuss views and analyses on the Russian/Ukraine conflict. The Council heard from global central bank experts on the economic and potential systemic implications for the Ukrainian, Russian, and EU regions, central banks, and other global stakeholders. The Russian economy makes for a particularly difficult assessment given the various confluent issues, including the sudden drop in stability, frozen financial systems, cessation of trade, and foreign direct investment (FDI) flight. The best-case scenario may be that its economy will be hit in a way not seen in five decades.

**Bottom-line considerations:** The Council members heard expert assessments of potential economic developments, including Russian default, energy and commodity price shocks, and the notion of cryptocurrency work-arounds to the sanctions. In terms of possible broader systemic disruptions, key considerations include the course and duration of the conflict; the global impacts of NRG supply and demand; Russian-dominated rare earth and other manufacturing disruptions; and, importantly, the size and stability of financial and central clearing counterparty and bank exposures to the Russia situation. The systemic implications of this horrific conflict are certainly significant but yet to be fully revealed.

*SR in the News*

# SYSTEMIC RISK IN THE NEWS

Systemic risk today is top of mind for investment professionals, economists, and anyone who is concerned about the stability and strength of the global economy. The following recent articles feature important, timely topics surrounding systemic risk and the global markets to keep us all up-to-date and in the know:

- *The End of Free-Lunch Economics* (*Project Syndicate,* January 31, 2022): Recent economic conditions may force fiscal and monetary policymakers with their expansionary policy programs to relearn old lessons the hard way.
- *War in Ukraine Threatens the Global Financial System* (*Financial Times*, March 3, 2022, behind a paywall): Regulators and investors are accustomed to dealing with shocks, but there is no room for complacency.
- *Too-Big-to-Fail Risk Looms Over Commodities* (*Washington Post*, March 17, 2022): The industry, a hidden giant of the global economy, is facing volatile market pricing and exposure.
- *Why Central Banks Got Serious About Digital Money* (*Washington Post*, March 2, 2022): Central banks around the globe are at varying stages of developing digital currencies.
- *What Could Possibly Go Wrong? These Are the Biggest Economic Risks for 2022* (*Bloomberg,* December 13, 2021)*:* Economists are mostly upbeat about 2022, but some dangers are ahead.

Two recent reports from the U.S. and EU areas assess the biggest threats to systemic risk:

- *The Office of Financial Research's Annual Report to Congress 2021* (November 2021): This annual report considers emerging threats like cybersecurity, climate change, and others in terms of vulnerabilities to financial stability in the United States.
- *Review of the EU Macroprudential Framework for the Banking Sector, European Systemic Risk Board* (March 2022): This report assesses vulnerabilities, risks, and challenges to the EU financial system as well as actions needed to ensure that our macroprudential rules for banks remain fit for purpose and future proof.

# SYSTEMIC RISK COUNCIL MEMBERS



 