CFA Institute®
Systemic Risk Council

QUARTERLY SYSTEMIC REPORT

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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.

CONTACT:
Kurt N. Schacht, JD, CFA
Executive Director
CFA Institute Systemic Risk Council
systemicriskcouncil.org
kurt.schacht@cfainstitute.org

Welcome to the Summer edition of the *Quarterly Systemic Report (QSR)*. Each quarter we recap the activities of the CFA Institute Systemic Risk Council (SRC or Council) and highlight the key systemic debates and challenges looming for global markets and regulators. We are in unprecedented times both in terms of numbers 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 building and urgent systemic concern. We provide an independent and clear assessment of the readiness of our regulatory institutions to deal with evolving systemic vulnerabilities and advocate for prompt action where improvements in detecting, monitoring, and responsiveness are needed to meet systemic risk threats.

This quarter we find ourselves deeply engaged on the "Great Unwind" of record stimulus, a crypto market in retreat, and an eerily quiet turn in commodities affected by the situation in Ukraine. We welcome your comments on the QSR and any suggestions for future topics in the report. — Kurt Schacht, Council Executive Director

SRC Updates

COUNCIL ADDS NEW EUROPEAN MEMBERS

Last spring, CFA Institute SRC announced that Marina Brogi of Italy, Andreas Raymond Dombret of Germany, and José Manuel González-Páramo of Spain had joined the Council. Erkki Liikanen, co-chair of the Council said, "We are thrilled to add these three very talented and experienced people to the SRC, broadening our European representation and adding important international perspectives to our Council discussions."

Marina Brogi is an Italian economist and full professor of banking and finance at Sapienza University of Rome, where she also served as deputy dean of the faculty of economics. She teaches international banking and capital markets as well as corporate governance in graduate, masters, doctoral, and executive courses at Sapienza University and other universities in Italy and abroad.

Andreas Raymond Dombret is a German–American banker and has served as a member of the executive board of Deutsche Bundesbank, the Supervisory Board of the European Central Bank (ECB), and on the Board of the Bank for International Settlements. Earlier in his career, he was vice chair of Bank of America in EMEA, co-head of Rothschild Germany, and managing director at JPMorgan in London and Frankfurt.

José Manuel González-Páramo is a Spanish economist who served as a member of the Executive Board of the ECB, and in 2013 was appointed executive board member of Banco Bilbao Vizcaya Argentaria, S.A. (BBVA). He is a professor of economics at the IESE Business School and the chair of the Supervisory Board of European DataWarehouse.

CHAIR OF THE COMMODITY FUTURES TRADING COMMISSION ON KEY SYSTEMIC RISK ISSUES

CFTC Chair Behnam

June SRC meeting: At our June meeting, the Council welcomed Rostin (Russ) Behnam, who was sworn in as the Commodity Futures Trading Commission's (CFTC) 15th chair on 4 January 2022 (with unanimous confirmation by the US Senate). The Council discussed a range of topics with Chair Behnam, including crypto-asset regulation; the Financial Stability Oversight Council (FSOC) and its collective role in regulating the crypto-asset space; other CFTC-regulated markets that could see further disruptions as a result of Ukraine-induced speculation; and global collaboration in the interest of stability for key energy markets and agricultural commodities.

Ukraine, market volatility, and futures industry preparedness: The conflict in Ukraine has placed added pressures on a global marketplace already challenged by pandemic-induced supply/demand imbalances. The CFTC has been focused on market trading function and resilience amid high volatility in a number of markets. Additional efforts have been on clearinghouse resilience, collateral, and margin levels—in expectation of continued volatility and price movements that could spike overnight. The Council raised issues of margin procyclicality and inevitable spikes in margin requirements. It was agreed that market players fully understand and are well prepared for these uncertain times.

Climate markets: The Council also discussed climate markets with Chair Behnam, noting the emerging nature of how carbon markets would develop, price, and potentially offer strategies to deal with the effects and risks of the transition toward a lower carbon economy. The cost and challenges of this transition to an entire range of commodity markets has and will continue to be an important topic for the CFTC.

Crypto oversight: Chair Behnam noted the ongoing discussions about the regulatory authority of both the US Securities and Exchange Commission (SEC) and CFTC to ensure that adequate oversight and enforcement authority extends to the crypto universe. Congress continues to debate what additional authorities are needed by current regulators to properly monitor and regulate a rapidly expanding crypto market or asset class. The CFTC continues to encourage more expeditious legislative authorizations to oversee the ever-expanding technology and global embrace of crypto-asset activities. Meanwhile, the CFTC oversees several new futures contracts tied to Bitcoin and Ethereum tokens. The Council noted its concerns that absent legislation, regulators are left to try various approaches under current rules and interpretations as they try to catch up to the industry. This has the potential to create systemic risk, say regulators.

Need for Legislative Action: While crypto (including stablecoins) has not risen to the level of a systemic threat—at least not yet—the Council believes the FSOC and Congress do not have the luxury of waiting until it has. The efforts of FSOC members have been ongoing, but they have failed to result in legislative action. A clear and sustained effort is now urgently needed.

CHAIR GENSLER DISCUSSES SEC'S MARKET RESILIENCY OBJECTIVES

SEC Chair Gensler

July SRC meeting: In July, SEC Chair Gary Gensler met with the Council to illuminate important SEC agenda items relating to systemic risk and market resilience. He emphasized the increasing role the SEC plays as a systemic risk agency, its financial stability oversight, and its remit to ensure fair, orderly, and efficient markets. Emphasizing their importnace, he noted that one-third of the 50 projects underway at the agency are focused on market resiliency objectives, including the following key topics:

Cybersecurity readiness: Chair Gensler talked about the ongoing effort and focus on cybersecurity and readiness. He noted the constantly evolving nature of the threat from private hackers to cyberattacks by foreign governments on our financial infrastructure and systems. These nation-state threats are particularly persistent and dangerous. As such, the SEC has unveiled a detailed set of proposed rules designed to improve cybersecurity preparedness in the wake of rising threats against financial institutions.

Money market fund liquidity risk management: Chair Gensler also discussed open-end fund "liquidity" matters, including the Commission's recent proposed amendments to certain rules that govern money market funds under the Investment Company Act of 1940. The SRC has provided written comments on the proposals, which are designed to address the March 2020 disruptions stemming from the Covid-19 pandemic, which led to stress on short-term funding markets similar to those experienced in previous disruptions, such as the Great Financial Crisis. Gensler stressed the SEC's desire to address "once and for all" concerns about prime and tax-exempt money market fund liquidity compromised again by the Covid-19 events. The SRC comment letter strongly supports Gensler's objective in this regard.

> **SRC Urges Financial System Actions Around Covid-19 Disruptions:** Never again should policymakers be forced to choose between taxpayer bailouts or financial collapse. We must implement strong and simple reforms now so that our markets can function fairly and freely in good times and in bad.

Crypto concerns: Chair Gensler noted crypto assets represent an ongoing concern and challenge for all global regulators. The members of the FSOC are all involved in ongoing discussion and analysis of a path forward. He sees the SEC as already having many touch points on crypto with regulated funds and public issuers who are in the crypto infrastructure space. Overall, the SEC regards cryptocurrency issues in three categories: (1) Stable coin products ($150 billion in market value); (2) alternative coins (undetermined value); and (3) more developed and already securitized coins like Bitcoin and Ethereum ($500 billion in market value). One statistical service (Crypto Space Statistics) estimates as of June 2022 there are 20,268 total cryptocurrencies with a total market cap of $1.025 trillion. Gensler noted the SEC staff are moving quickly to understand and sort out the regulatory considerations, including the various blockchain and other technology players key to trading custody and clearing the action. Three SEC projects are in progress considering (1) jurisdictional authority; (2) whether the SEC can and should register tokens; and (3) the need to register exchanges and certain crypto intermediaries. Gensler noted his interest and appreciation for the SRC's recent comment letter to the FSOC on crypto/stablecoin oversight.

Moving issues forward: Council members raised other important points with Chair Gensler, including the following:

- Current legislative proposals pending on crypto oversight
- The complexity and fragmentation challenges associated with the expanded cross-border nature of many crypto assets
- Reduced global cooperation and the decoupling of regulation regarding crypto—every jurisdiction wants a piece of the emerging technologies and market innovations
- The potential systemic risk of tossing time-tested market structure rules and foundational securities regulations in the clamor to accommodate crypto-related technologies and other digital trading products. New, light touch regulation could easily present systemic challenges

Uncertain times: The Council will continue to monitor and assess the work of the SEC and other regulators in the face of possible recession, sticky inflation, interest rate hikes, commodity spikes, and developments around the conflict in Ukraine.

SYSTEMIC RISK IN THE NEWS

With continued global economic strains, the ongoing Russian–Ukraine conflict, and renewed supply chain disruptions, systemic risk threats are on the rise and in the news. Following are several key reports and interesting pieces that we've gathered to keep us all up to date:

- *House Punts on Stablecoin Bill After Yellen Raises Flags Over Key Provision* (*Politico*, 25 July 2022): House Financial Services Committee lawmakers will delay the markup of a widely anticipated bipartisan stablecoin bill this week after Treasury Secretary Janet Yellen pushed for changes in a key provision of the legislation. The move underscores Washington's struggle to create new rules for digital asset marketplaces that have been roiled by uncertainty following the collapse of several multibillion-dollar crypto startups.
- *The Fed Must Emulate the Tactics of Volcker's Fight Against Inflation* (*Financial Times*, behind a paywall, 22 July 2022): Federal Reserve Chair Jay Powell mirrors the former Fed chair Paul Volcker's bravery but not his methods. While Volcker fought inflation by restraining growth in money supply, Powell's approach is aggressively raising interest rates. If he is to tame inflation expectations, Powell must strongly signal that he is prepared to keep monetary policy tight through recessions.
- *A Broken System Needs Urgent Repairs* (*The Economist*, behind a paywall, 21 July 2022): The environmental, social, and governance (ESG) approach to investment is broken. It needs to be streamlined and reorganized. Alleged "greenwashing"—misstating the use of ESG criteria in investment portfolio—has marked a low point for asset managers around the world.
- *The European Systemic Risk Board (ESRB) General Board Meeting* (ESRB press release, 30 June 2022): At its meeting on 23 June, the General Board of the ESRB concluded that risks to financial stability have increased. The significant deterioration in global economic growth prospects, the Russian invasion of Ukraine, and the normalization of monetary policy causing a rise in the cost of financing have heightened uncertainty and the probability that tail risk scenarios may materialize.
- *Regulate Stablecoins. Please!* (*Financial Times*, behind a paywall, 10 June 2022): It is time for regulators to get creative and use their current powers to act on regulating stablecoins. The SEC has a regulatory model tailor-made for stablecoin issuers: government money market funds (MMFs). Government MMFs have proved to be safe and resilient in times of stress, because they must invest their reserves in cash and highly liquid federally backed securities that are subject to strict rules around investor disclosures and transparency. Subjecting stablecoin issuers to these rules would make this market safer for investors.
- *Can the Fed Manage Inflation and Recession?* (Columbia Global Reports, 1 June 2022): Over the years, the erosion of banking law and the rise of alternative forms of money created outside of the banking system have pushed the Fed to take on more and more responsibilities. Our chronic dependency on the central banking system—and thus, private banks—has failed to benefit the broader public, even in times of crises. It is time to reform the US economic and financial infrastructure.
- *The Case for Central Bank Digital Currencies* (*The International Economy*, Spring 2022): With the proliferation of digital currencies, central banks might be best situated to lead the development of a central bank digital currency as an alternative to physical cash. They are the competent monetary authorities, enjoy the trust of the broader society, can ensure close coordination with policymakers, and ensure an initiative is well-embedded in the broader financial system.

SYSTEMIC RISK COUNCIL MEMBERS

Chair: Simon Johnson

SRC Co-Chair and former IMF Chief Economist

Chair: Erkki Liikanen

SRC Co-Chair and Chair of the IFRS Foundation Board of Trustees

Kurt N. Schacht, JD, CFA

Executive Director, CFA Institute Systemic Risk Council

Senior Advisor: Sheila C. Bair

Founding Chair of Systemic Risk Council and former FDIC Chair

Senior Advisor: Jean-Claude Trichet

Former President of the European Central Bank

Members:

Paul P. Andrews

Managing Director, Research, Advocacy, and Standards, CFA Institute; former Secretary General of the International Organization of Securities Commissions (IOSCO)

Brooksley Born

Former U.S. Commodity Futures Trading Commission Chair

Sharon Bowles

Former Member of European Parliament and former Chair of the Parliament's Economic and Monetary Affairs Committee

Bill Bradley

Former US Senator (D-NJ)

Marina Brogi

Full Professor of Banking and Capital Markets at Sapienza University of Rome and a former member of the Securities and Markets Stakeholder Group at the European Securities and Markets Authority (ESMA)

Andreas Raymond Dombret

Former member of executive board Deutsche Bundesbank, founding member of the Supervisory Board of the European Central Bank, and board member of the Bank of International Settlements

William Donaldson

Former US SEC Chair

José Manuel González-Páramo

Spanish economist who served as a member of the Executive Board of the European Central Bank (ECB), member of the Executive Board of Banco Bilbao Vizcaya Argentaria, S.A. (BBVA), and member of the Executive Board of the Bank of Spain

Jeremy Grantham

Co-founder and Chief Investment Strategist, Grantham Mayo Van Otterloo (GMO)

Richard Herring

Wharton School of the University of Pennsylvania

Sallie Krawcheck

Chair, Ellevate, former Senior Executive, Citi and Bank of America Wealth Management

Ira Millstein

Senior Partner, Weil Gotshal & Manges LLP

John S. Reed

Former Chair and CEO of Citicorp and Citibank

Commented [m1]: CFA style calls for the use of Chair (*not* Chairman)

The word "former" can be set lowercase unless it is the first word in the affiliation.

For Gonzalez-Paramo, please reconcile hyphenation (most common usage seems to be hyphenated). But see https://www.systemicriskcouncil.org/members/jose-manuel-gonzalez-paramo/ where it is not hyphenated in the heading but is hyphenated in the text.