

Overview of Progress in the Implementation of the G20 Recommendations for Strengthening Financial Stability

Report of the Financial Stability Board to G20 Leaders

19 June 2012

Table of Contents

	Page
1. Introduction	1
2. Building resilient financial institutions	3
3. Ending “Too-Big-To-Fail”	7
4. Strengthening the oversight and regulation of shadow banking	13
5. Creating continuous core markets – OTC derivatives reforms.....	17
6. Creating continuous core markets – Strengthening and converging accounting standards.....	20
7. Creating continuous core markets – Other market reforms	22
8. Enhancing compensation practices	26
9. Building and implementing macroprudential frameworks and tools.....	27
10. Strengthening adherence to international financial standards.....	29
11. Strengthening FSB governance.....	31
12. Other issues	32

1. Introduction

Since the onset of the global financial crisis, the G20 has established core elements of a new global financial regulatory framework that will make the financial system more resilient and better able to serve the needs of the real economy.

National authorities and international bodies, with the Financial Stability Board (FSB) as a central locus of coordination, have further advanced this financial reform programme, based on clear principles and timetables for implementation.

The FSB coordinates and closely monitors the national implementation of agreed G20 and FSB financial reforms and is responsible for reporting on it to the G20. The FSB set up in October 2011 a Coordination Framework for Implementation Monitoring (CFIM), in collaboration with international standard-setting bodies (SSBs), to intensify its monitoring and public reporting on implementation, focusing in particular on priority reform areas.

This report details the progress made in global policy development and in implementation of global policy reforms since the G20 Cannes Summit in November 2011.

A central piece of the international policy reforms is stronger minimum standards for bank capital and liquidity through implementation of Basel II, II.5 and III requirements. As of end-May 2012¹:

- 20 of 27 member jurisdictions of the Basel Committee on Banking Supervision (BCBS) had implemented the Basel II.5 rules to strengthen capital charges for banks' trading books and complex securitisations, which were due to come into force from end-2011. Six member countries have not issued final regulations in this area.
- 20 of 27 BCBS member jurisdictions have issued draft or final Basel III regulations, implementation deadline for which is 1 January 2013. Seven member jurisdictions have yet to do so, but the majority of these believe they can issue final regulations by the implementation deadline.

Another central reform objective is ending "too big to fail" through strengthened resolution regimes and resolution planning for global systemically important banks (G-SIBs):

- Encouraging progress has been made by major jurisdictions, including the US, UK and EU, to put in place or propose legislation to establish effective resolution regimes;
- However, although cross-border crisis management groups (CMGs) have been established for 24 of the 29 G-SIBs, much further work is needed to develop resolution strategies and plans, and the cross-border co-operation agreements needed to ensure the resolvability of these G-SIBs.

With regard to reforms to over-the-counter (OTC) derivatives markets, all jurisdictions and markets need to aggressively push ahead to achieve full implementation of market changes by end-2012 to meet the G20 commitments in as many reform areas as possible:

¹ By 12 June, the US authorities published draft Basel III rules for comment and approved final rules covering the market risk elements of Basel II.5.

- Good progress has been made by those jurisdictions with the largest OTC derivatives markets, including the United States (US), European Union (EU) and Japan, in advancing national legislation and regulation and practical implementation of reforms to market infrastructures;
- SSBs have also made significant progress in developing the international policies that are key to advancing OTC derivatives reform implementation across jurisdictions. All jurisdictions now have sufficient information about international standards and policies to put in place the needed domestic legislation and regulation.

With regard to reform of compensation structures at financial institutions:

- Almost all FSB member jurisdictions have now implemented the FSB Principles and Standards for sound compensation practices in regulation or supervisory guidance. Since Cannes, jurisdictions that showed significant gaps have progressed. However, sustained supervisory and regulatory attention will be needed to achieve lasting improvements in financial firms' compensation structures and practices.

Since the Cannes Summit, the FSB and its members have made good progress in policy development in areas where G20 objectives have been agreed, including developing proposals for public consultation on extending the framework for systemically important financial institutions (SIFIs) to cover global insurers and domestic banks, measures to address the regulation and oversight of shadow banking, and the development of a governance framework for a global Legal Entity Identifier (LEI) system.

An important goal of the monitoring process is to highlight, for corrective action, areas where there are risks that policy objectives will not be met, or where implementation is not meeting the agreed timelines. Among these areas:

- Although CMGs have been established, much further work on resolution plans and on cross-border co-operation is needed to improve resolvability. Progress is being made in national legislative reforms to establish more effective resolution regimes. The standards set out in the FSB's November 2011 Key Attributes of Effective Resolution Regimes provide international standards in this area, and the detailed assessment methodology being developed will provide further guidance.
- Many jurisdictions still need to address weaknesses in their supervisors' mandates, to ensure sufficient independence to act, appropriate resources, and a full suite of powers to proactively identify and address risks. The Basel Core Principles are being strengthened in this area, with a consultative paper having been issued last December.

The following sections describe in greater detail the progress made by the FSB and its members to promote financial stability and strengthen the resilience of the global financial system, including through surveys conducted by the FSB's Implementation Monitoring Network (IMN).

2. Building resilient financial institutions

2.1 Implementation of Basel II/II.5/III

The G20 Leaders, at the Cannes Summit, reaffirmed their commitment to improve banks' resilience to financial and economic shocks, and called on jurisdictions to meet their commitment to implement fully and consistently the Basel II/II.5/III requirements.

The Basel III framework seeks to strengthen the resilience of the banking system through prudential measures that will enhance the quality of capital; increase the level of capital; promote the build-up of capital buffers to mitigate pro-cyclicality; supplement the risk-based capital requirements with a leverage ratio; and introduce a set of global liquidity standards. Together with the Basel II and Basel II.5 frameworks, Basel III will improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source, thus reducing the risk of spillover from the financial sector to the real economy.

The BCBS with the endorsement from GHOS, meanwhile launched in January 2012 a comprehensive process to monitor its members' implementation of Basel II/II.5/III. The process consists of three levels of review:²

- (i) Level 1: ensuring the timely adoption of Basel II/II.5/III;
- (ii) Level 2: ensuring consistency of domestic regulations with Basel II/II.5/III; and
- (iii) Level 3: ensuring consistency of outcomes (initially, this assessment of implementation at the bank level will focus on risk-weighted assets).

The three-level monitoring framework will promote timely and consistent implementation of Basel II/II.5/III and also provide inputs to the FSB's reporting to the G20 Leaders on implementation of priority reforms.

On the timely adoption of Basel II/II.5/III (Level 1), the BCBS published in October 2011, April 2012 and June 2012 reports that detailed the progress BCBS members have made in implementing Basel II/II.5/III. As of end-May 2012, 21 of 27 BCBS member jurisdictions have implemented Basel II, which was due to come into force from end-2006.³ In addition, Indonesia and Russia have implemented Basel II's Pillar 1 (minimum capital requirements). Argentina, China, Turkey and the US are in the process of implementing Basel II.

With regard to Basel II.5, as of end-May 2012, 20 BCBS member jurisdictions had implemented those rules, which were due to come into force from end-2011. Argentina, Indonesia, Mexico, Russia, Turkey and the US had not issued final regulations. The US authorities approved final rules covering the market risk elements of Basel II.5 in early June 2012. Saudi Arabia has issued final regulations but these have not yet come into force. Among the 29 G-SIBs identified in November 2011⁴, nine are headquartered in jurisdictions that have not yet fully implemented Basel II or Basel II.5.

² For details, see <http://www.bis.org/publ/bcbs216.pdf>.

³ <http://www.bis.org/publ/bcbs220.pdf>

⁴ http://www.financialstabilityboard.org/publications/r_111104bb.pdf

Draft Basel III regulations had not been issued by seven BCBS member jurisdictions as of end-May 2012: Argentina, Hong Kong, Indonesia, Korea, Russia, Turkey and the US. The US authorities however have since then published the draft Basel III rules. The majority of these countries believe they can issue final regulations by the implementation deadline of 1 January 2013. However, for the others, depending on their domestic rule-making process, meeting the deadline could pose a significant challenge.

In addition to monitoring the timely adoption of Basel III rules, the BCBS has established a process to review the content of the new national rules for the implementation of Basel III. This second level of review is meant to ensure that the national adaptations of Basel III are consistent with the minimum Basel III standards. The BCBS has initiated peer reviews of the domestic regulations of the EU, Japan and the US to assess their consistency with the globally agreed standards. The findings of these reviews are preliminary since the analysis is not yet completed and the formulation of national standards is still ongoing. Nevertheless, there is a possibility that national and regional implementation will be weaker than the globally agreed standards in some key areas.

A third level of review by the BCBS examines whether there are unjustifiable inconsistencies in risk measurement approaches across banks and jurisdictions, and the implications these might have for the calculation of regulatory capital. This review will initially focus on banks' risk-weighting practices in the banking and trading books, and includes the use of test portfolio exercises, horizontal reviews of practices across banks and jurisdictions, and joint on-site visits to large, internationally active banks.

The BCBS intends to develop an updated progress report by the time of the G20 Finance Ministers and Central Bank Governors meeting in November 2012 that includes: (i) an update on its members' domestic rule-making; (ii) the final outcome of the regulatory consistency assessment of the EU, Japan and the US; and (iii) preliminary findings from its deeper analysis of banks' risk measurement approaches and regulatory capital calculations.

A review of the consistency of Singapore's regulations with the international standards (i.e. a Level 2 review) will commence later in 2012, with reviews of China and Switzerland to follow in 2013. This schedule ensures that all countries that are home to G-SIBs will have been reviewed before the middle of 2013. Reviews of Australia, Brazil and Canada will take place during the second half of 2013. The BCBS is collaborating with the International Monetary Fund (IMF) and World Bank to ensure that its schedule is complementary and non-duplicative to the Financial Sector Assessment Program (FSAP) review process.

2.2 Liquidity standards under Basel III

A key component of the Basel III framework is the introduction of global liquidity standards. During the financial crisis, the banking system experienced severe stress because many banks did not manage their liquidity in a prudent manner. Basel III's Liquidity Coverage Ratio (LCR), is designed to promote short-term resilience by ensuring a bank holds adequate highly liquid assets to survive significant stress lasting for one month. The other standard, the Net Stable Funding Ratio (NSFR), is intended to promote a sustainable maturity structure of assets and liabilities and thereby avoid significant maturity mismatches over longer-term horizons.

To better understand the potential effect of these standards, the Basel Committee on Banking Supervision (BCBS) agreed to put in place rigorous reporting processes to monitor the LCR and NSFR during an observation period that began in 2011. The BCBS' oversight body, the Group of Central Bank Governors and Heads of Supervision (GHOS), requested in January 2012 that the LCR rules text be clarified so that the 100% threshold would be a minimum requirement in normal times and banks would be expected to use their pool of liquid assets during the stress period, thereby temporarily falling below the minimum requirement. The GHOS also asked the BCBS to finalise and publish recommendations by the end of 2012 to address specific concerns regarding the pool of high-quality liquid assets as well as some adjustments to the calibration of net cash outflows so as to reflect the actual experience during the crisis. The BCBS is working towards finalising the LCR by the end of 2012, with a view to implementing it in January 2015. The NSFR will be implemented in January 2018.

2.3 Quantitative impact assessment of Basel III⁵

Apart from monitoring the timely and consistent implementation of Basel II/II.5/III across member jurisdictions, the BCBS is conducting a semi-annual monitoring exercise to assess the impact of Basel III on a representative sample of institutions in each member jurisdiction. According to the most recent results (as of 30 June 2011)⁶, if changes to the definition of capital and risk-weighted assets were applied without considering the transitional arrangements, the average common equity Tier 1 capital ratio (CET1) of Group 1 banks would have been 7.1%, higher than the Basel III minimum requirement of 4.5%.⁷ For the other banks (Group 2 banks), the average CET1 ratio stood at 8.3%.

The BCBS has also estimated that the sum of profits after taxes and prior to distributions during the second half of 2010 and the first half of 2011 would cover about 70% of the capital that the Group 1 banks need to raise over the coming six-year implementation horizon to satisfy the 7% target for CET1 and the surcharge for G-SIBs.⁸ Meanwhile, for the smaller Group 2 banks, the capital shortfall to be met over the same horizon is much less than these banks' profits. There is considerable variation across individual banks, so it is difficult to draw firm conclusions from the BCBS estimates. However, the averages may suggest that a proportion of the industry has the capacity to meet the new capital targets through earnings retention and reduced distributions over the transition period.

On the other hand, the estimated impact of the Basel III liquidity standards by the BCBS seems to suggest the need for banks to further adjust their liquidity positions during the observation period, for example, through lengthening the term of their funding or restructuring business models which are most vulnerable to liquidity risk in periods of stress. Assuming banks were to make no changes to their liquidity risk profile or funding structure,

⁵ Please see section 12.2 for details of a study to identify the extent to which the agreed regulatory reforms may have unintended consequences for emerging market and developing economies.

⁶ <http://www.bis.org/publ/bcbs217.pdf>

⁷ Group 1 banks are those that have Tier 1 capital in excess of €3 billion and are internationally active. There were 103 Group 1 banks covered in this exercise.

⁸ This estimate is based on the capital shortfall generated from an assessment of banks' portfolios as at end-June 2011 on a Basel III basis. As such, in the determination of the shortfall amount, no assumptions were made about changes in bank capital or balance sheet composition going forward.

as of June 2011, the weighted average Liquidity Coverage Ratio (LCR) for Group 1 banks would have been 90% while the weighted average LCR for Group 2 banks was 83%. The weighted average Net Stable Funding Ratio (NSFR) was 94% for both Group 1 and Group 2 banks. Banks have until 2015 to meet the LCR standard and until 2018 to meet the NSFR standard. The BCBS is currently investigating the case for modifying a few key aspects of the LCR but will not materially change the framework's underlying approach. The BCBS will finalise and subsequently publish its recommendations in these areas by the end of 2012.

2.4 Strengthening risk management

Risk management functions are the first line of defence in enhancing the resilience of financial institutions. In this regard, the FSB, SSBs and national authorities are making continuous efforts to strengthen risk management practices through increased supervisory expectations, enhancements of risk disclosures (market discipline), and additional guidance for national authorities and financial institutions.

Across the FSB member jurisdictions, supervisory expectations for risk governance have increased, particularly for SIFIs, as this was an area that exhibited significant weaknesses in many financial institutions during the global financial crisis. To take stock of changes underway in risk governance practices, the FSB launched a thematic review on risk governance in March 2012. The peer review will also assess progress in addressing the weaknesses in risk governance identified during the crisis at both national authorities and at firms. The inclusion of a firm-level survey in the peer review reinforces the message that a firm's board and senior management are responsible for managing its risk, while supervisors are responsible for assessing whether a firm's risk governance framework and processes are adequate, appropriate and effective for managing the firm's risk profiles. The peer review report will be published in the first half of 2013.

In addition, the FSB hosted a roundtable on risk disclosures by financial institutions in December 2011 to encourage the private sector to jointly take forward development of principles and of leading practice disclosures that will be relevant and informative given current market conditions and risks. Given the importance to market confidence of useful disclosure by financial institutions of their risk exposures and risk management practices, the FSB facilitated the formation of a private-sector Enhanced Disclosure Task Force (EDTF) in May 2012.⁹ The primary objectives of the EDTF are to: (i) develop principles for enhanced disclosures, based on current market conditions and risks, including ways to enhance the comparability of disclosures; and (ii) to identify leading practice risk disclosures. The recommendations of the EDTF are expected to be reported to the FSB and published in October 2012.

The BCBS issued in May 2012 a consultative document that set out a revised market risk framework and proposed a number of specific measures to improve trading book capital requirements.¹⁰ These proposals are aimed at fundamentally strengthening capital standards for market risk, an area where weaknesses became apparent during the crisis. The key elements of the proposals include: a more objective boundary between the trading book and

⁹ http://www.financialstabilityboard.org/press/pr_120510.pdf

¹⁰ <http://www.bis.org/publ/bcbs219.htm>

banking book that materially reduces the scope for regulatory arbitrage; and the introduction of the expected shortfall as a risk measure that better captures “tail risk” compared to value-at-risk.

The BCBS also issued a consultative paper on *The Internal Audit Function in Banks* in December 2011, which provides guidance to help assess the effectiveness of a bank's internal audit function.¹¹ This is a revision of the BCBS' 2001 document *Internal Audit in Banks and Supervisor's Relationship with Auditors*. The proposed guidance reflects developments in supervisory and banking practices and incorporates lessons drawn from the financial crisis.

To strengthen liquidity risk management practices of collective investment schemes (CIS), the International Organisation of Securities Commissions (IOSCO) published in April 2012 a consultation report entitled *Principles of Liquidity Risk Management for Collective Investment Schemes*.¹² These Principles are intended to be used by both the industry and regulators in assessing the quality of regulation and industry practices relating to liquidity risk management for CIS. The fundamental requirement is to ensure that the degree of liquidity managed by an open-ended CIS enables it to meet redemption obligations and other liabilities. The consultation report describes how compliance with this requirement can be achieved. IOSCO also published in January 2012 *Principles on Suspensions of Redemptions in Collective Investment Schemes*, a report that provides a common approach and standards for use in an exceptional case where CIS face serious liquidity problems.¹³

National authorities have also been making efforts to strengthen the risk management practices of financial institutions in their jurisdictions. In particular, many jurisdictions are enhancing their liquidity risk management and stress testing practices in line with the Basel III rules and BCBS guidelines, such as:

- In *Canada*, OSFI's final Liquidity Guideline (B-6) which is in line with BCBS requirements has been in force since February 2012. Financial institutions' implementation of the B-6 guideline will be reviewed during Q2 2012 through a cross-system benchmarking review/self-assessment. Financial institutions also periodically submit liquidity data related to BCBS liquidity standards.
- In *Hong Kong*, the supervisory guideline on stress testing has been revised to incorporate the BCBS' guidance and the recommendations from other international organisations to address deficiencies in this area that were revealed by the global financial crisis. The revised guideline was issued on 9 May 2012.¹⁴

3. Ending “Too-Big-To-Fail”

The G20 is determined to make sure that no financial institution is “too big to fail” and that taxpayers do not bear the costs of resolution of any institution that does fail (and cannot be put into insolvency for reasons of systemic stability). To this end, the G20 Leaders endorsed

¹¹ <http://www.bis.org/publ/bcbs210.pdf>

¹² <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD378.pdf>

¹³ <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD367.pdf>

¹⁴ <http://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/supervisory-policy-manual/IC-5.pdf>

at the Cannes Summit the FSB's comprehensive policy framework, comprising a new international standard for resolution regimes, more intensive and effective supervision, and requirements for cross-border cooperation and recovery and resolution planning as well as, from 2016, additional loss absorbency for those banks determined as global systemically important financial institutions (G-SIFIs or G-SIBs).

3.1 Improving the capacity to resolve firms in crisis

The FSB *Key Attributes of Effective Resolution Regimes for Financial Institutions* ("the Key Attributes") form an international standard that sets out the essential elements that all resolution regimes should have to ensure that national authorities can resolve financial institutions in an orderly manner that does not expose taxpayers to the risk of loss. FSB members have committed to an ambitious schedule for bringing their resolution regimes in line with this new standard and for implementing a range of G-SIFI specific requirements, including (i) the establishment of Crisis Management Groups, (ii) the elaboration of recovery and resolution plans (RRPs), (iii) the conduct of resolvability assessments, (iv) the adoption of institution-specific cross-border cooperation agreements (COAGs); and (v) the establishment of cooperation arrangements with the relevant jurisdictions that are hosts to systemic operations of a G-SIFI but are not represented on its CMG. The progress made to date on implementing the G-SIFI framework includes the following key elements:

- (i) **Effective resolution regimes.** A self-assessment by FSB members indicated that national resolution regimes are not fully consistent with the Key Attributes in many FSB member jurisdictions. However, reforms are underway to align the regimes more closely with the Key Attributes. For example, the implementation of the Dodd-Frank Act (DFA) in the US, which provides for powers to resolve systemically important financial institutions and requires the preparation of resolution plans, constituted an important step towards implementation of the Key Attributes. Likewise, the European Commission (EC)'s adoption of proposed EU-wide rules for bank recovery and resolution¹⁵ is critical for advancing consistent reforms across the EU. FSB members have committed to undergo a first thematic peer review of resolution regimes in the second half of 2012 which should provide a fuller picture of the status of national reform and progress in implementing the FSB standard.
- (ii) **Crisis Management Groups (CMGs).** CMGs have been established for 24 G-SIFIs. Where a CMG is not yet established, substantive action is planned. CMG membership includes the prudential supervisor, central bank and, where it is a separate authority, the resolution authority of the home country; in some, the finance ministry of the home or host jurisdiction participates in a restricted manner. The countries represented in the CMGs are generally the same as those in the G-SIFI's core supervisory college. Senior level engagement has proved critical for advancing cooperation and resolution planning work within CMGs. A few CMGs have discussed detailed resolution strategies and started to develop operational plans to implement them.

¹⁵ http://ec.europa.eu/internal_market/bank/docs/crisis-management/2012_eu_framework/COM_2012_280_en.pdf

- (iii) **Recovery and resolution plans (RRPs).** Advancing more detailed CMG work on resolution planning, resolvability assessments and cooperation agreements has proved difficult without a clearly articulated resolution strategy – that is, the specification of a high level, strategic approach to how a firm would be resolved. The FSB has therefore given priority to the development - led by home authorities - of high-level resolution strategies by September 2012. Such strategies include “single entry” or “top down” approaches, where a group is resolved through intervention at the level of the holding company; or “multiple-entry resolution” approaches where separate resolution action may be taken at the level of subsidiaries. The chosen resolution strategies should provide sufficient direction to CMGs for them to undertake more detailed work on the development of cooperation agreements, RRP’s and resolvability assessments. For each G-SIFI, home authorities have committed to lead the development within the CMGs of resolution plans that set out in detail how the resolution strategies could be put into operation by the end 2012.
- (iv) **Resolvability assessments.** Resolvability assessments should help identify any remaining barriers to resolution. They should also inform the development and/or improvement of the resolution plan. Discussions of resolvability assessments of G-SIFIs are at very early stages, due in part to the fact that resolution strategies need first to be developed before their feasibility and credibility can be assessed. CMGs should conduct resolvability assessments in Q1 2013, after the development of basic resolution strategies for all G-SIFIs.
- (v) **Institution-specific cooperation agreements.** No institution-specific cooperation agreements consistent with the Key Attributes have as yet been agreed or put in place between the members of a CMG, largely because the development of a resolution strategy is seen as a prerequisite to such an agreement and also because differing terms and conditions for information sharing across jurisdictions complicate cross-border cooperation. The FSB has therefore initiated further work to examine how to address existing obstacles to the exchange of information, and to develop minimum common terms and content for information sharing across jurisdictions. These terms and content should be reflected in the cooperation agreements to be put in place for all G-SIFIs in early 2013.
- (vi) **Coordination with host jurisdictions with systemic G-SIFI operations.** Effective cooperation should be established with the relevant host authorities that are not included in the CMGs, but that assess the local operations of a G-SIFI as systemically important to the local financial system. The FSB is therefore also proposing to develop further guidance for arrangements and procedures for cooperation and information sharing with such host authorities.¹⁶

The FSB identified several areas where further work is necessary to advance recovery and resolution planning and improve resolvability. The Key Attributes state the need for the effective segregation of client assets and prompt access to segregated client funds in

¹⁶ In identifying domestic systemically important subsidiaries of G-SIBs, it is suggested that home authorities and CMGs consider the methodology the BCBS is developing to identify D-SIBs.

resolution. Further work will be undertaken on these topics, in coordination with IOSCO and the FSB Shadow Banking workstream.

To facilitate assessments by the IMF and World Bank of resolution regimes against the Key Attributes, the FSB is developing a draft assessment methodology with the assistance of a drafting team composed of resolution experts from FSB member jurisdictions, EU institutions, IAIS, CPSS and IOSCO¹⁷, who have the appropriate sectoral expertise, and from the IMF, the World Bank and International Association of Deposit Insurers (IADI), who have particular experience in the development and use of assessment methodologies. Given the status of the Key Attributes as “umbrella” standards for resolution regimes for all types of financial institutions that can potentially be systemically-important in failure, the methodology will incorporate sector-specific considerations. The draft methodology will be submitted to all SSBs in the second half of 2012 to help to determine whether the methodology is suitable for assessing resolution regimes for different types of firms, including FMIs, insurers and securities and investment firms.

The questionnaire to be used for the FSB’s thematic peer review of resolution regimes will be based on the draft assessment methodology and the findings from that review will be taken into account when the methodology is finalised in 2013.

3.2 Improving the intensity and effectiveness of SIFI supervision

The FSB continued to review progress towards implementation of the 32 recommendations set out in the November 2010 report *Intensity and Effectiveness of SIFI Supervision* (SIE recommendations) relating to supervisory mandates, powers, resources and practices for making the supervision of financial institutions more effective.¹⁸ The majority of these recommendations have been implemented or are underway. The coming year will see a completion of this work, as well as implementation of additional recommendations set out in the 2011 *Progress Report on Implementing the Recommendations on Enhanced Supervision*.¹⁹ These include raising supervisory expectations about firms’ abilities to collect and process data to give an accurate picture of their firm-wide risk exposure, promoting strong risk management, and ensuring that supervisors have adequate resources to supervise SIFIs effectively.

While discussions among FSB members on increasing the intensity of supervision are related to all SIFIs, they are generally focused on institutions that are important for the global system (i.e. G-SIFIs). The FSB’s agenda for improving the intensity and effectiveness of supervision is focused on four main areas: (i) holding supervisors to higher standards; (ii) improving supervisory tools and methods; (iii) enhancing the effectiveness of supervisory colleges; and (iv) improving firms’ risk data aggregation capabilities. A summary of progress in each of these areas is discussed below.

- (i) **Holding supervisors to higher standards:** At the core of strengthened supervisory frameworks are the minimum standards set out by the BCBS for sound

¹⁷ CPSS-IOSCO will publish a consultation paper in July 2012 on the recovery and resolution of FMIs that analyses how the Key Attributes should apply to this sector to ensure effective resolution of different types of FMIs.

¹⁸ http://www.financialstabilityboard.org/publications/r_101101.pdf

¹⁹ http://www.financialstabilityboard.org/publications/r_111104ee.pdf

supervisory practices. The BCBS published in December 2011 a consultative document on the enhanced *Core Principles for Effective Banking Supervision* (BCBS Core Principles).²⁰ In developing the revised BCBS Core Principles, close attention was given to addressing many of the significant risk management weaknesses and other vulnerabilities highlighted in the last crisis. Final principles are expected to be published in the fall 2012. National authorities will be assessed as part of the IMF-World Bank FSAPs against the enhanced BCBS Core Principles, thus raising the bar for supervisors.

- (ii) **Improving supervisory tools and methods:** Since the beginning of 2012, the FSB has been working to improve its understanding of risk appetite frameworks, resources needed to intensify SIFI supervision, firms' business models, and supervisory methods used to oversee trading operations. Discussions have revealed that (a) most G-SIFIs have a risk appetite statement but both firms and supervisors have difficulty determining its suitability; (b) while resources at supervisory authorities have increased since the financial crisis, the pace of increase has not been commensurate with higher regulatory and supervisory demands placed on supervisors, such as supervisory colleges and CMGs; (c) supervisory approaches to understanding business models vary in part due to resource constraints and lack of expertise; and (d) supervisors see operational risk as the next big risk which cannot be solved entirely by higher capital. While progress is being made in these areas, more work is needed. The FSB will be developing recommendations on how to ensure supervision of these areas is more intense, more effective and more reliable to promote financial stability.
- (iii) **Enhancing the effectiveness of supervisory colleges:** As recommended by the SIE report, the BCBS and IAIS are studying how to improve the operations of supervisory colleges in order to ensure a more rigorous and coordinated assessment of the risks facing the G-SIFIs. In the second half of 2012, the FSB will also be discussing the means to enhance the effectiveness of supervisory colleges, in particular for G-SIFIs.
- (iv) **Improving firms' risk data aggregation capabilities:** The BCBS is acting on the SIE recommendation to develop supervisory expectations for firms' risk data aggregation capabilities. A paper setting out principles for effective risk data aggregation and risk reporting is under development. The principles will be finalised by the end of the year and G-SIBs are expected to implement these principles by the beginning of 2016, which is the start of the phase-in period for the added loss absorbency requirements for G-SIBs. Supervisors will start discussing implementation with senior management of these firms from early 2013 and ensure that the G-SIBs develop strategies to meet the principles by early 2016.

3.3 Extending the SIFI framework

After the comprehensive framework for addressing the "too-big-to-fail" problem was agreed at the Cannes Summit, the G20 Leaders asked the FSB in consultation with the BCBS, to

²⁰ <http://www.bis.org/publ/bcbs213.pdf>

extend expeditiously the G-SIFI framework to D-SIBs. The IAIS was asked with the development of an assessment methodology for the identification of global systemically important insurers (G-SIIs) and to continue its work on a common framework for the supervision of internationally active insurance groups (ComFrame). The G20 Leaders also called on the FSB to prepare methodologies to identify global systemically-important non-bank financial entities (non-bank G-SIFIs) by end-2012 in consultation with IOSCO.

3.3.1 Domestic systemically important banks

The FSB, in consultation with the BCBS, submitted to the G20 Finance Ministers and Central Bank Governors in April 2012 a progress report on the modalities to extend the G-SIFI framework to D-SIBs.²¹ The G-SIB framework assesses the externalities from a global perspective (i.e., where distress or failure would disrupt the global financial system), making no distinctions about impacts on individual jurisdictions. The policy framework envisaged for D-SIBs would take the perspective of individual jurisdictions. That is, it addresses the impact of failure associated with the local presence of a bank - whether a national or an internationally-active bank – in a given jurisdiction. The D-SIB framework being considered would be based on assessments by local authorities, who are best placed to identify the banks which are systemically-important relative to the domestic economy.

An important aspect of a D-SIB framework relates to its compatibility with the G-SIB framework, to ensure that adequate and consistent incentive structures are in place at the domestic as well as at the international level. The principles for D-SIBs being considered therefore seek to establish a minimum framework that would ensure compatibility with the G-SIB framework, address the cross border externalities that the failure of a D-SIB may nonetheless pose, and preserve a level playing field within and across jurisdictions. The principles would include guidelines for national authorities to assess the systemic importance of banks in a domestic context.

The BCBS is developing a set of principles as a common framework for D-SIBs, including on the issues of compatibility with the G-SIB framework, home-host coordination, and the instruments and composition of additional loss absorbency for D-SIBs. The FSB and BCBS will submit the outcome of this work to the G20 Finance Ministers and Central Governors meeting in November 2012.

3.3.2 Systemically important insurers

The IAIS has made progress in developing a proposed assessment methodology for identifying G-SIIs. A consultation paper was issued in May 2012 on the proposed IAIS assessment methodology for identifying G-SIIs.²² The paper included some initial thoughts on the policy measures that should apply to G-SIIs and further development of potential policy measures is underway. Potential measures include enhanced supervision, improved resolvability, structural measures, higher loss absorbency and restrictions on certain activities. A consultation paper on proposed policy measures will be issued in September 2012. The IAIS will deliver to the G20 in April 2013 a consolidated paper on the assessment

²¹ http://www.financialstabilityboard.org/publications/r_120420b.pdf

²² <http://www.iaisweb.org/Consultations-918>

methodology and the policy measures. At that time, the FSB and national authorities, in consultation with the IAIS, will determine the initial cohort of G-SIIs. Meanwhile, IAIS' work on developing a common framework for internationally active insurance groups (ComFrame) is progressing and its development phase is expected to be completed in 2013.

3.3.3 Systemically important non-bank financial entities²³

In response to the request of the G20 Leaders, the FSB, in consultation with IOSCO, is preparing methodologies for identifying non-bank G-SIFIs whose distress or disorderly failure would cause significant disruption to the wider financial system and economic activity at the global level. This is in line with the methodologies developed for identifying G-SIBs and also with that of G-SIIs issued for consultation by the IAIS in May. In developing the methodologies, the FSB will focus on detailed design issues such as the scope of application, applicability of materiality criteria, modus operandi and data availability.

At the national level, meanwhile, the US Financial Stability Oversight Council (FSOC) published in April 2012 the final rule and the interpretive guidance regarding the process and criteria to be used for designating non-bank financial institutions for consolidated supervision by the Federal Reserve System and enhanced prudential standards as their material financial distress – or the nature, scope, size, scale, concentration, interconnectedness, or mix of its activities – could pose a threat to the US financial stability.²⁴ Based on the published rule, the FSOC could make the first of these designations during 2012.

4. Strengthening the oversight and regulation of shadow banking

At the Cannes Summit, the G20 Leaders agreed to strengthen the oversight and regulation of the shadow banking system, and endorsed the FSB's initial recommendations with a work plan to further develop them in 2012. At the request of the G20, a progress report on shadow banking was submitted to the G20 Finance Ministers and Central Bank Governors in April 2012.²⁵

The “shadow banking system” which can be broadly described as “credit intermediation involving entities and activities outside the regular banking system” has become an integral part of the modern financial system that has an important role in supporting the real economy. However, the shadow banking system can also pose risks to the financial system, on its own and through its links with the regular banking system.

The FSB issued initial recommendations in its October 2011 report *Shadow Banking: Strengthening Oversight and Regulation* to address potential risks in the shadow banking system.²⁶ It has adopted a two-pronged approach. First, the FSB will enhance the monitoring framework through continuing its annual monitoring exercise to assess global trends and

²³ Systemically-important non-bank financial entities (or non-bank G-SIFIs) exclude banks, insurers and financial market infrastructures.

²⁴ <http://www.treasury.gov/initiatives/fsoc/Documents/Nonbank%20Designations%20-%20Final%20Rule%20and%20Guidance.pdf>

²⁵ http://www.financialstabilityboard.org/publications/r_120420c.pdf

²⁶ http://www.financialstabilityboard.org/publications/r_111027a.pdf

risks, with more jurisdictions participating in the exercise. Second, the FSB will develop recommendations to strengthen the regulation of the shadow banking system, where necessary, to mitigate the potential systemic risks with specific focus on the five areas explained in section 4.2. An initial integrated set of policy recommendations will be developed by the end of 2012. A properly structured and regulated shadow banking sector can make the financial system more robust, efficient and diversified; hence, the reforms in this area will seek to mitigate systemic risks while preserving the scope for realising those benefits.

4.1 Strengthening oversight of the shadow banking system

The FSB has set out recommendations for effective monitoring of shadow banking in its October 2011 Report and also committed to conduct annual monitoring exercises to assess global trends and risks in the shadow banking system. The global monitoring exercise conducted in 2011 covered eleven FSB member jurisdictions and the euro area. The coverage of the 2012 monitoring exercise will be extended to cover the remaining FSB jurisdictions. The annual monitoring exercise is expected to facilitate the national authorities' assessment of shadow banking risks based on the FSB recommendations, and the sharing of experiences among authorities in order to highlight trends in shadow banking that are of relevance to the stability of the global financial system.

In addition to participation in the FSB annual monitoring exercise, a few jurisdictions have also taken steps to enhance the monitoring of shadow banking in their jurisdictions. For example:

- In *Australia*, the Reserve Bank of Australia (RBA) will provide an annual update on the shadow banking system to the Council of Financial Regulators (CFR). This should identify any emerging risks, which may lead to changes to regulatory arrangements if that is warranted.
- In *Canada*, the Office of the Superintendent of Financial Institutions (OSFI) has initiated work to examine Canadian banks' interactions with shadow banking entities, in the context of the Canadian marketplace. The Bank of Canada is also expanding the resources devoted to assessing risks and vulnerabilities in the financial system, including the shadow banking system. It is developing a shadow banking monitoring framework in coordination with other federal and provincial authorities, focusing on the channels through which shocks can be propagated through the financial system.
- The European Central Bank (ECB) has proposed the creation of an EU Central Database on Euro Repos as a joint effort by public authorities and the financial industry.²⁷ This is to address the lack of granular data on the repo market in the euro area, with the aim to allow better monitoring from a financial stability perspective.
- In the *US*, FSOC provides US regulators with a surveillance mechanism and allows for a flexible approach to address potential risks in the shadow banking system. Under the Dodd-Frank Act (DFA), FSOC has the discretion to subject any non-bank financial company to a detailed review if the company could pose a threat to US

²⁷ <http://www.ecb.int/press/key/date/2012/html/sp120427.en.html>

financial stability. That company would then be subject to heightened prudential standards. The DFA requires that FSOC's Annual Report address significant financial market and regulatory developments, along with an assessment of developments on the stability of the financial system; potential emerging threats to financial stability; and, recommendations to enhance the integrity, efficiency, competitiveness. As a result of DFA, the SEC expanded its regulatory scope and is now collecting additional information through Form PF on hedge funds and private equity funds that have at least \$150m in assets under management to better monitor their activities.

4.2 Strengthening regulation of the shadow banking system

Based on the initial recommendations and work plans set out in the October 2011 Report, five workstreams have been launched to advance the work to develop proposed policy recommendations.

- (i) **Banks' interactions with shadow banking entities:** With the objective of mitigating the spill-over effects between the regular banking system and the shadow banking system, the BCBS will propose, where needed, to regulate banks' interactions with shadow banking entities by July 2012. It is currently reviewing the consolidation rules for prudential purposes; limits on the size and nature of a bank's exposures to shadow banking entities; risk-based capital requirements for banks' exposures to shadow banking entities; and the treatment of reputational risk and implicit support.
- (ii) **Money market funds (MMFs):** IOSCO was tasked to develop by the autumn 2012 policy recommendations to reduce the susceptibility of MMFs to "runs". IOSCO published in April 2012 a consultation report that provides an analysis of the systemic importance of MMFs and their key vulnerabilities, including their susceptibility to runs, and sets out possible policy options to reinforce the soundness of MMFs and to address the identified systemic vulnerabilities.²⁸ The possible policy options include: a mandatory move from constant to variable net asset value (NAV); enhancement of MMF valuation and pricing framework; enhancement of liquidity risk management; and reduction in the importance of ratings in the MMF industry. These options are not mutually exclusive and some may be considered in combination. IOSCO envisages using the outcomes of the consultation to narrow down the policy options into policy recommendations.
- (iii) **Other shadow banking entities:** An FSB workstream is developing policy recommendations by September 2012, where appropriate, on the regulation of shadow banking entities other than MMFs to mitigate their systemic risks. The Workstream has completed a categorisation and data collection exercise for a wide range of non-bank financial institutions (or Other Financial Intermediaries (OFIs)). After casting the net wide through this exercise, the Workstream is adopting a two-step prioritisation process to narrow the scope to certain types of entities that may need policy responses. The first step is to develop a list of entity types (filtered list) for closer scrutiny based on national experience (i.e. authorities' judgements) and

²⁸ <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD379.pdf>

size; the second step entails the detailed assessment of the shadow banking risk factors (e.g. maturity transformation, liquidity transformation and leverage) with respect to each entity type in the filtered list. The Workstream plans to analyse the filtered entities by looking at their economic functions rather than legal names or forms. In this way, the Workstream aims to develop potential policy recommendations that can be applied across jurisdictions to all entities that have the same economic function, while taking account of the heterogeneity of economic functions carried out by different entities within the same sector.

- (iv) **Securitisation:** To assess and align the incentives associated with securitisation to prevent it creating excessive leverage in the financial system, IOSCO, in coordination with the BCBS, is examining the (i) retention requirements and (ii) measures that are aimed at enhancing transparency and standardisation related to securitisation. As the first phase of its work, the European Commission (EC) and the US Securities and Exchange Commission (SEC) staff have completed a comparison of securitisation rules in the EU and US. Building on this work, IOSCO has conducted an analysis of global regulatory and industry initiatives on risk retention, transparency and standardisation, as well as the identification and assessment of material differences in regulatory/industry approaches and their impact. Draft policy recommendations are set out in a consultation report published in June 2012.²⁹ Based on the comments received on the consultation report, IOSCO will publish the final report in late 2012.
- (v) **Securities lending and repos:** An FSB workstream is examining the regulation of secured financing contracts such as repos, and securities lending from a financial stability perspective, by the end of 2012. The Workstream published in April 2012 its interim report which covers an overview of the securities lending and repo markets; key drivers of the securities lending and repo markets; its location within the shadow banking system; overview of existing regulatory framework; and financial stability issues.³⁰ The financial stability issues identified by the Workstream include (i) lack of transparency, (ii) pro-cyclicality of system leverage and interconnectedness through valuation, haircuts and collateral re-use, (iii) other issues associated with re-use of collaterals, (iv) potential risks arising from fire-sale of collateral assets, (v) potential risks arising from securities lending activities, (vi) shadow banking through cash collateral reinvestment, and (vii) insufficient rigour in collateral management and valuation. Based on its mapping of the markets and identification of financial stability issues, the Workstream will develop policy recommendations as necessary by the end of 2012.

In addition to the policy-making work at the FSB-level, some national and regional authorities have embarked on initiatives to address potential risks arising from the shadow banking system in their respective jurisdictions. For example:

- In *Australia*, the Australian Securities and Investments Commission (ASIC) will be producing an internal report by 30 June 2012 on MMFs. Any further work in this

²⁹ <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD382.pdf>

³⁰ http://www.financialstabilityboard.org/publications/r_120427.pdf

sector will be informed by the internal report and its conclusions regarding whether or not appropriate regulation is in place.

- In the *EU*, the EC issued in March 2012 a *Green Paper on Shadow Banking* that draws from the FSB's October 2011 report. The paper takes stock of current developments and presents on-going reflections on the subject to gather views from the stakeholders, in order to enable the EC to actively respond and contribute to the global debate.³¹
- In the *US*, authorities have taken many steps to address potential systemic risks to financial stability emanating from the shadow banking system. In addition to the establishment of FSOC and its authority to designate a non-bank financial firm for prudential supervision, the US has taken policy measures that seek to address risks posed by money market funds, private investment funds, securitisation activities and the tri-party repo market. For example, the SEC adopted new rules in February 2010 to increase the resilience of MMFs to economic stresses, and reduce the risks of runs by tightening maturity and credit quality standards and imposing new liquidity requirements. The new rules include provisions to: improve liquidity, credit quality and disclosure, and require periodic stress tests. The DFA imposes new requirements relating to asset-backed securities, including those for risk retention, disclosure, and conflict of interest.

5. Creating continuous core markets – OTC derivatives reforms

In September 2009 in Pittsburgh, the G20 Leaders agreed that all standardised OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties (CCPs) by end-2012 at the latest; OTC derivative contracts should be reported to trade repositories (TRs); and non-centrally cleared contracts should be subject to higher capital requirements. The FSB published a report, *Implementing OTC Derivatives Markets Reforms*, in October 2010 that set out 21 recommendations to address practical issues in implementing the G20 Leaders' commitments.³² The FSB's OTC Derivatives Working Group has been monitoring the implementation of the OTC derivatives markets reforms, with reports to the FSB every six months.

In October 2011, the FSB published its second progress report on the implementation of OTC derivatives reform, cautioning that, with only just over one year until the end-2012 deadline for implementing the G20 commitments, few FSB members had the legislation or regulations in place to provide the framework for operationalising the commitments.³³ Since then, as noted in the FSB's third progress report published in June 2012, encouraging further progress has been made in setting international standards, the advancement of national legislation and regulation by a number of jurisdictions and practical implementation of reforms to market infrastructures and activities.³⁴ The report concludes that all jurisdictions and markets need to

³¹ http://ec.europa.eu/internal_market/bank/docs/shadow/green-paper_en.pdf

³² http://www.financialstabilityboard.org/publications/r_101025.pdf

³³ http://www.financialstabilityboard.org/publications/r_111011b.pdf

³⁴ http://www.financialstabilityboard.org/publications/r_120615.pdf

aggressively push ahead to achieve full implementation of market changes by end-2012 to meet the G20 commitments in as many reform areas as possible. Jurisdictions have sufficient information about international standards and policies to put in place the needed legislation and regulation. They should do so promptly, and in a form flexible enough to respond to cross-border consistency and other issues that may arise.

Broadly speaking, the jurisdictions currently with the largest markets in OTC derivatives – the EU, Japan and the US – are the most advanced in structuring their legislative and regulatory frameworks. They expect to have regulatory frameworks in place by end-2012 and practical implementation within their markets is well underway. Other jurisdictions are generally less advanced although, as the third progress report indicates, progress has been made by many of them, particularly with respect to central clearing and reporting to TRs. The development of implementing regulations to require exchange or electronic platform trading, where appropriate, is generally less advanced. National implementation of capital requirements for exposures to CCPs and margining requirements for non-centrally cleared contracts is awaiting international principles that are currently under development.

One reason for the slower timetables in some jurisdictions has been that authorities had been waiting for the key elements of the regulatory frameworks in the EU, Japan and the US to be finalised before putting their own legislation in place, in an effort to be consistent with these frameworks. Additionally, some jurisdictions have sought greater certainty about the application of international principles and safeguards to cross-border financial market infrastructure, including CCPs and TRs, so as to make an informed decision about the appropriate form of market infrastructure for their jurisdiction.

Since the October 2011 progress report, SSBs have made significant progress in developing international policies, notably:

- CPSS and IOSCO issued the *Principles for FMIs* (PFMIs) in April 2012.³⁵ These principles, which harmonise, strengthen and replace the previously separate sets of principles for different types of FMIs, are an important milestone in the global development of a sound basis for central clearing of all standardised OTC derivatives.
- IOSCO published its *Report on Requirements for Mandatory Clearing* in February 2012, providing important guidance for jurisdictions on the process for setting the scope of central clearing requirements.³⁶
- CPSS and IOSCO published in January 2012 a *Report on OTC derivatives data reporting and aggregation requirements*, recommending that TRs implement measures to provide authorities with effective and practical access.³⁷
- IOSCO published its Final Report on International Standards for Derivatives Market Intermediary Regulation in June 2012, which recommends high-level international standards for the regulation of market participants that are in the business of dealing, making a market or intermediating transactions in OTC derivatives.³⁸

³⁵ <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD377.pdf>

³⁶ <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD374.pdf>

³⁷ <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD366.pdf>

³⁸ <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD381.pdf>

Additionally, the Committee on the Global Financial System (CGFS) published in November 2011 a report *The macrofinancial implications of alternative configurations for access to central counterparties in OTC derivatives markets* that analyses the implications for financial stability of the alternative arrangements for access to CCPs (such as through large global or smaller regional or domestic CCPs) and assesses the potential trade-offs involved.³⁹ IOSCO published in January 2012 additional analysis of the characteristics of different types of organised trading platforms, following on from its February 2011 report.⁴⁰ International workstreams are also progressing rapidly to develop frameworks for a global LEI (see section 7.1); guidance on resolution of CCPs (see section 3.1); capital adequacy rules for exposures to CCPs; international standards on margin requirements for non-centrally cleared derivatives; and work on regulatory access to data from TRs.

In January 2012, the FSB identified four safeguards for a resilient and efficient environment for central clearing, on which substantial progress should be made by mid-2012 to support national authorities in deciding whether to rely on domestic or global clearing infrastructure to meet the G20 commitment to centrally clear all standardised OTC derivatives. Substantial progress has now been made, through SSB workstreams and otherwise, to provide these safeguards and thus allow authorities to make their decisions.

The safeguards, and the steps taken to achieve them, are: (i) fair and open access by market participants to CCPs, based on transparent and objective criteria (addressed within the PFMI); (ii) cooperative oversight arrangements between all relevant authorities, both domestically and internationally and on either a bilateral or multilateral basis, that result in robust and consistently applied regulation and oversight of global CCPs (addressed as a minimum standard through the responsibilities for authorities set out in the PFMI and in practice through individual cooperative agreements in place or in development for CCPs); (iii) resolution and recovery regimes that ensure the core functions of CCPs are maintained during times of crisis and that consider the interests of all jurisdictions where the CCP is systemically important (CPSS and IOSCO plan to issue in July a consultation paper on the application of the Key Attributes of Effective Resolution Regimes to CCPs and other FMIs); and (iv) appropriate liquidity arrangements for CCPs in the currencies in which they clear (addressed within the PFMI and through conclusions of the Economic Consultative Committee of the Bank for International Settlements (BIS)).

The FSB, through its OTC Derivatives Working Group, seeks to identify any overlaps, gaps or conflicts in national frameworks or implementation that might compromise the achievement of the G20 commitments, particularly where there may be a risk that such issues will not be satisfactorily resolved through existing bilateral or multilateral channels. Additionally, the FSB has established the OTC Derivatives Coordination Group, comprising the chairs of the BCBS, CGFS, CPSS, IOSCO and the FSB, to discuss on a regular basis the coordination of international workstreams on OTC derivatives reforms.

The progress achieved to date is contributing to the broader G20 goals of improving transparency, mitigating systemic risk and protecting against market abuse. This is an important part of FSB's broader efforts to end "too big to fail" and to support continuously

³⁹ <http://www.bis.org/publ/cgfs46.pdf>

⁴⁰ <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD368.pdf>

open markets. To assist in doing so, the FSB will seek to further improve data and other survey information on the extent to which OTC derivatives are in practice standardised, centrally cleared, traded on organised platforms and reported to TRs. For the next progress report, the FSB intends to put additional focus on the readiness of infrastructures to provide central clearing, platform trading and reporting of OTC derivatives, the practical ability of industry to meet the requirements and the remaining steps for the industry to take.

At the Cannes Summit, the G20 Leaders requested IOSCO to assess the functioning of credit default swaps (CDS) markets and the role of those markets in price formation of underlying assets. In response to the G20 request, IOSCO has prepared a report that analyses the CDS markets as a whole⁴¹, including both corporate and sovereign CDS markets (prioritising sovereign CDS markets) and encompasses:

- an examination of existing research on the functioning of CDS markets, notably information about the trading, pricing and clearing of CDS;
- the nature of the CDS markets, e.g. type or level of volatility and liquidity and the links to the cost of funding; and
- recent experience with the functioning of the CDS markets, e.g. the effect of a 50% write down on Greek debt triggering or not triggering a default for CDS purposes.

6. Creating continuous core markets – Strengthening and converging accounting standards

At the Cannes Summit, G20 Leaders reaffirmed their objective to achieve a single set of high quality global accounting standards and meet the objectives set at the London summit in April 2009, notably as regards the improvement of standards for the valuation of financial instruments. They called on the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) to complete their convergence project and requested a progress report at the G20 Finance Ministers and Central Bank Governors meeting in April 2012. They also looked forward to the completion of proposals to reform the IASB governance framework.

Nearly all FSB member jurisdictions have either adopted IASB standards (International Financial Reporting Standards - IFRS) or have programmes underway to converge with, or consider adoption of, IFRS by end-2012. The US SEC continues to work toward determining whether to incorporate IFRS into the financial reporting system for US issuers. Foreign private issuers in the US are already allowed to follow IFRS.

As requested by the G20 Leaders, a joint update report from the two standard setters was provided to the FSB and to the G20 Finance Ministers and Central Bank Governors in April 2012.

- While important improvements to their standards on financial instruments' fair values and off-balance sheet entities were finalised in 2011, the convergence process is taking longer than initially expected in some areas, such as classification, measurement and

⁴¹ <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD385.pdf>

provisioning. Also, the Boards are not addressing hedge accounting issues jointly. At the Cannes Summit, the FSB encouraged the Boards to redouble their efforts to seek converged standards in these important areas.

- While delays have taken place, the IASB and FASB are making progress on projects to converge their standards on financial instruments, including a joint expected loss impairment (“provisioning”) approach and a more converged approach to classification and measurement. Consistent with earlier FSB recommendations, it will be important that the IASB and FASB final standard on expected loss impairment result in improved provisioning practices that will incorporate a broader range of available credit information than existing provisioning requirements, so as to recognise credit losses in loan portfolios at an earlier stage.
- The IASB and FASB will conduct further public consultations in the second half of 2012, and expect to issue final converged standards in a number of key areas by mid-2013. The two Boards have extended certain project target completion dates in order to allow sufficient time for extensive outreach and public comment on the large number of planned major Exposure Drafts, and for the Boards to reflect that feedback in high-quality final standards.

The FSB supports the efforts of the IASB and FASB to achieve convergence to a globally accepted set of high-quality accounting standards and urges them to issue final converged standards on key projects by their expected timeframe of mid-2013.⁴²

The netting/offsetting of derivative contracts and other financial assets and financial liabilities is another area where the FSB has expressed concerns. In this case, different approaches result in significant differences in total assets and/or total liabilities in balance sheets of large financial institutions. After considering the comments of stakeholders the Boards decided to maintain their current different offsetting accounting models but to improve and converge related disclosure requirements. After the Cannes Summit the Boards issued in December 2011 new requirements for common disclosures about gross and net positions for derivatives and other financial instruments. This followed the Boards’ issuance of a joint proposal in January 2011 on a converged accounting approach to balance sheet netting. However, instead of supporting the joint 2011 proposal, commenters from the US generally supported the current FASB netting rules and those using IFRS generally supported current IASB rules, with many investors seeking both gross and net information. Derivatives dealer banks, both inside and outside the US, generally wanted the FASB (net) accounting approach in order to avoid a very significant grossing-up of their balance sheets.

The FSB noted that differences in the offsetting/netting accounting standards would adversely affect the efforts to develop an internationally comparable leverage ratio for capital purposes. However, from a bank supervisory perspective, there may be more convergence for the Basel III leverage ratio purpose than is first apparent. While the IASB and FASB have decided to maintain their different accounting rules for netting/offsetting, the FASB netting approach and the netting approach that will be carried forward to the Basel III leverage ratio are similar in

⁴² Following their meeting in April 2012, the communiqué of the G20 Finance Ministers and Central Bank Governors said “We support . . . the efforts of the IASB and FASB to achieve convergence to a globally accepted set of high quality accounting standards and urge them to meet their target of issuing standards on key convergence projects by mid-2013, at the latest, in order to achieve a single set of high quality international accounting standards”.

their effect because both recognise netting/offsetting for derivatives based on legally enforceable master netting agreements without requiring the intent or ability to net in the normal course of business.

Following a request at the Cannes Summit, reforms were announced in February 2012 by the IFRS Foundation (IFRSF) Trustees and the IFRSF Monitoring Board to improve the governance of the IASB. These include internal organisational changes as well as reforms that seek to enhance the involvement of key stakeholders, including those from emerging market economies, and improve the technical dialogue of the IASB with market regulators, investors and prudential authorities. The internal changes and reforms are being implemented in a manner that will enhance the IASB's efficiency and effectiveness. The IASB provided a report on these governance reforms to the G20 Finance Ministers and Central Bank Governors in April 2012.⁴³

7. Creating continuous core markets – Other market reforms

7.1 Building a common legal entity identifier

At the Cannes Summit, the G20 Leaders supported the creation of a global LEI which uniquely identifies parties to financial transactions, and called on the FSB to take the lead in helping coordinate work among the regulatory community to prepare recommendations for a governance framework for such a global LEI that is consistent with the public interest. To meet that request, the FSB has prepared a report (LEI Report) containing recommendations to implement a global LEI system.⁴⁴

The global LEI system would contribute to and facilitate many financial stability objectives, including: improved risk management in firms; better assessment of micro and macro-prudential risks; facilitation of orderly resolution; containing market abuse and curbing financial fraud; and enabling higher quality and accuracy of financial data overall. It would mitigate operational risks within firms by reducing the need for tailored systems to reconcile the identification of entities and to support aggregation of risk positions and financial data, which impose substantial deadweight costs across the economy. It would also facilitate straight-through-processing.

The LEI Report contains 35 recommendations for the development and implementation of the global LEI system. These recommendations are guided by a set of “Global LEI System High Level Principles” which set out the objectives that the design of a global LEI system must meet. The broad goal of the proposals is to put in place a strong global governance framework to protect the public interest, while promoting an open, flexible, and adaptable operational model for the global LEI system. The proposals draw on input and advice from the FSB LEI Industry Advisory Panel. The suggested code and initial reference data are consistent with the standard developed for the LEI by the International Organization for Standardization (ISO) through an industry consensus process (ISO 17442:2012).

⁴³ http://www.financialstabilityboard.org/publications/r_120420d.pdf

⁴⁴ http://www.financialstabilityboard.org/publications/r_120608.pdf

A three-tier structure for the global LEI system based on a federated approach is recommended:

- The first element is a Regulatory Oversight Committee (ROC). This will carry the ultimate responsibility for the governance of the global LEI system in the public interest. The ROC will be established by endorsement of a proposed global LEI Regulatory Oversight Committee Charter which will set out the governance framework and arrangements. It will comprise authorities that support the High Level Principles and purposes of the LEI, and will have an Executive Committee to steer the work under guidelines to be set out in the Charter.
- The second component is a Central Operating Unit (COU) which will form the pivotal operational arm of the global LEI system. Key tasks of the COU will be to implement agreed central operational standards that ensure uniqueness of the LEI and that deliver a “logically” centralised database of high quality reference data (such as name and address, and, over time, information on ownership relationships). In legal form, the COU will be a not-for-profit foundation (or equivalent). It will be composed of private industry representatives from the various geographic regions and sectors.
- The third part of the system will be federated Local Operating Units (LOUs). The LOUs will be the local implementers of the global system. They will conduct local registration of legal entities and will be responsible for the validation and maintenance of the high quality reference data. Using local systems will facilitate the use of local languages and operational types. LOUs may also build on local infrastructure such as business registries and numbering agencies. LOUs may be operated either by private or public bodies. They will, however, need to adhere to the agreed global standards to ensure that the system delivers high quality and consistent information. In this context, interim local solutions could be subsequently integrated into the proposed global LEI framework.

The FSB’s objective is to have a fully functioning self-standing governance and operational framework for the global LEI system by March 2013. The timeline and deliverables in moving towards that objective are as follows:

- Submission of the Global LEI ROC Charter to the FSB in October 2012 or the G20 in November 2012 for endorsement;
- Development of the necessary legal framework for the functioning of the ROC and the COU; and
- Development of the legal and technological framework for the proposed global LEI foundation and operational model.

An Implementation Group, comprised of experts from the global regulatory community is being formed to advance this workplan. The Implementation Group will work in close coordination with experts from private industry.

7.2 Reducing reliance on credit ratings and improving oversight of credit rating agencies

In February 2012 the FSB conducted a review of its members' compliance with the FSB *Principles for Reducing Reliance on Credit Rating Agency (CRA) Ratings*.⁴⁵ The aim of these Principles, issued in October 2010, is to reduce mechanistic reliance on CRA ratings that can amplify procyclicality and contribute to systemic disruption through herding behaviour and selloffs of securities when they are abruptly downgraded ("cliff effects"). In the period since the FSB Principles were issued, widespread CRA rating downgrades have further underscored the importance of these issues.

The FSB Principles encourage banks, institutional investors and other market participants to develop their own internal risk management capabilities to avoid mechanistic reliance on external credit ratings. CRA ratings should be an input, but no more than that, to the risk assessment process. Creating the right incentives for market participants to develop their risk management capabilities includes reducing the use (or "hard wiring") of CRA ratings in regulatory regimes. The hard wiring of CRA ratings has been wrongly interpreted as providing them with an official "seal of approval" and has contributed to an undesirable reduction in firms' own capacity for credit risk assessment and due diligence.

Specifically, the report found that:

- A few jurisdictions have passed, or proposed, wide-ranging legislative or regulatory measures to reduce reliance on CRA ratings, but are facing difficulties in detailed implementation.
- International standard setters have taken steps to examine the references to CRA ratings in their standards and, in some cases, to discourage undue reliance on CRA ratings within those standards. In a number of cases, study of the issue was either ongoing or was only just getting under way.
- The modest progress described in the report was due in part to the challenge of developing alternative risk assessment capabilities and processes. These are essential to permit individual firms and official bodies to reduce their reliance on CRAs while maintaining adequate management of credit risk. When the Principles were written it was recognised that this would take time, and for some market participants the process could take several years. However, the report concluded that the authorities can do more to facilitate this process by identifying the changes in practices that need to be made, sharing experiences and effective practices in developing reforms bearing in mind the need for international consistency, and establishing timetables and milestones for the transition.

The report called for clear milestones to be set out for the transition to a reduced reliance on CRA ratings over the medium term; in many cases those milestones remain to be defined. Among the steps it recommended are:

- Further actions by national and regional regulators to encourage the appropriate use of CRA ratings as an input, but no more than that, to the risk assessment process.

⁴⁵ http://www.financialstabilityboard.org/publications/r_101027.pdf

- Setting standards that actively promote the use of market participants' own risk management capabilities rather than reliance on CRA ratings.
- SSBs should promote the sharing of successful practices to strengthen credit risk capabilities.
- Official sector bodies should publicly explain their approach to credit risk assessment in their market and investment operations and the further steps planned to align their practices with the FSB Principles.
- Further comparative analysis of actions to identify hindrances to removing references to CRA ratings in standards, laws and regulations, as well as help re-align national work plans with the FSB Principles.

To encourage further progress on the above issues, the FSB will organise a workshop in September 2012 that will bring together SSBs and national experts to review progress and agree on the next steps. The output from the workshop will feed into a further progress report for the G20 Finance Ministers and Central Bank Governors meeting in November.

Other than the efforts to reduce mechanistic reliance on CRA ratings, most FSB members have already put in place requirements for the registration of CRAs. Regulatory action is still in progress in two jurisdictions.

- In *Mexico*, CRAs have been required to be authorised since 1999. In February 2012, draft regulations were published to enhance the requirements for authorisation, including improvements on structured finance ratings and transparency.
- *Saudi Arabia* is currently developing its CRA Regulations, which will specify the procedures and conditions for obtaining an authorisation. These regulations will be in line with IOSCO's *Code of Conduct Fundamentals for Credit Rating Agencies* (CRA Code).⁴⁶

A significant proportion of FSB members have also taken actions to improve CRA practices and procedures, such as the adoption of the IOSCO CRA Code, inclusion in relevant rules/regulations of the requirements for assuring the transparency and quality of the rating process, and providing full disclosure of their ratings track record.

7.3 Enhancing market disclosure and functioning

The financial markets are a potential transmission mechanism for systemic crisis, especially when market participants are faced with significant uncertainty, and engage in panic behaviour. In this regard, IOSCO has taken steps to strengthen market disclosure and enhance investor protection. IOSCO published in February 2012 a consultation report *Principles for Ongoing Disclosure for Asset-Backed Securities*⁴⁷ that provides guidance for securities regulators who are developing or reviewing their regulatory regimes for ongoing disclosure for asset-backed securities (ABS) so as to enhance investor protection. IOSCO issued in March 2012 a consultation report on *Principles for the Regulation of Exchange Traded Funds* which listed some common principles and guidelines relating to ETFs on investor protection,

⁴⁶ <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD271.pdf>

⁴⁷ <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD372.pdf>

sound functioning of markets and financial stability.⁴⁸ In response to the G20 Leaders' request at the Cannes Summit, IOSCO also published in March 2012 a consultation report containing proposals to improve the functioning and oversight of Price Reporting Agencies in the oil markets⁴⁹ and has also published its update report to the G20 in June 2012.⁵⁰ In addition, IOSCO published in February 2012 a consultation report on *Suitability Requirements with respect to the Distribution of Complex Financial Products*, seeking views on common principles relating to suitability and disclosure standards for market intermediaries in relation to the distribution of complex financial products.⁵¹

8. Enhancing compensation practices

The 2011 FSB peer review on compensation indicated that good progress had been made in implementing the FSB Principles and Standards on Sound Compensation Practices ("Principles and Standards", P&S), but that more work was necessary to overcome constraints to full implementation by individual national authorities and to address concerns by firms of an uneven playing field.⁵² In response to the G20 Leaders' request, the FSB established a Compensation Monitoring Contact Group (CMCG) comprising national experts from member jurisdictions with regulatory or supervisory responsibility on compensation practices. The CMCG is responsible for monitoring and reporting to the FSB on national implementation of the P&S.

The progress report sent separately to G20 Leaders is the first outcome of this monitoring exercise, which is not as deep as a peer review.⁵³ The progress report describes the developments in implementing the P&S since the October 2011 thematic peer review. Almost all FSB member jurisdictions have now completed the implementation of the P&S in their national regulation or supervisory guidance. Those jurisdictions that still showed significant gaps at the time of the 2011 peer review (Argentina, India, Indonesia, Russia, and South Africa) have progressed in their implementation efforts. However, in the case of Indonesia and Russia, the relevant regulation is currently under review and it has not yet been issued. Moreover, some other jurisdictions (Argentina, Brazil, China, India, and Turkey) have elected not to implement one or more Standards related to the alignment of compensation with risk taking, either because they are not deemed applicable or because of domestic constraints (e.g. labour laws).

All jurisdictions that have not fully implemented the P&S will need to continue their efforts to overcome impediments to full implementation in order to ensure an outcome that is fully consistent with the objectives of the P&S. The reasons for not implementing specific Principles or Standards, as well as the nature of the actions taken to address identified

⁴⁸ <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD376.pdf>

⁴⁹ <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD375.pdf>

⁵⁰ <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD383.pdf>

⁵¹ <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD373.pdf>

⁵² http://www.financialstabilityboard.org/publications/r_111011a.pdf

⁵³ http://www.financialstabilityboard.org/publications/r_120613.pdf

impediments, will be reported to the FSB by the relevant jurisdictions and will be described in the next progress report.

In many jurisdictions supervisory attention continues to increase – indeed, a high level of supervisory engagement is reported to contribute to greater attention to compensation issues by firms. Most authorities report that firms in their jurisdiction have made good progress and generally confirm that especially significant firms do not show major implementation gaps, although some challenges remain where more progress is needed, in particular in the area of alignment of compensation with ex-ante risk taking and with ex-post performance and concerning identification of material risk takers. Especially in these areas more supervisory cooperation would be beneficial.

The FSB has also established in early 2012 a mechanism for national supervisors from FSB member jurisdictions to bilaterally report, verify and, if necessary, address specific compensation-related complaints by financial institutions that derive from level playing field concerns. All FSB members have informed the relevant financial institutions operating in their jurisdiction of the main features of the Bilateral Complaint Handling Process (BCHP). Although it is not possible to estimate a priori the volume of complaints that will be received, the process itself is designed to create the right incentives for implementation of the P&S by firms and to dispel their concerns relating to lack of information or adequate processes to address level playing field issues.

The findings of the ongoing monitoring confirm that achieving lasting change in behaviour and culture within firms is a long-term challenge requiring a sustained commitment and that additional time is needed for effective and consistent implementation of the P&S to take place. The FSB will continue to monitor and report on progress so as to generate substantive and relevant information that provides further impetus to aligning compensation practices to prudent risk taking behaviour.

9. Building and implementing macroprudential frameworks and tools

The G20 Leaders stated at the Cannes Summit that “We are developing macroprudential policy frameworks and tools to limit the build-up of risks in the financial sector, building on the ongoing work of the FSB-BIS-IMF on this subject.” While a small number of jurisdictions (e.g. UK, US, EU) have established new institutional structures with macroprudential mandates, many others are implementing enhancements within the existing institutional arrangements. A number of jurisdictions are enhancing their macroprudential frameworks and powers to gather data that are needed for monitoring systemic risk, for example:

- In *Switzerland*, the Financial Stability Working Group (MoF, SNB, FINMA) published in March 2012 a report on proposals to amendments of regulatory systems. With respect to this, two amendments to the Capital Adequacy Ordinance are planned: the early introduction of a countercyclical capital buffer; and an increase in capital requirements for risky mortgage lending business. Furthermore, a majority of the group has recommended the creation of a right to direct access for the SNB to information on financial market participants which goes beyond its existing entitlement to statistical data.

- In the *US*, the DFA created the FSOC to provide comprehensive monitoring of risks to financial stability, promote market discipline, and respond to emerging threats. The FSOC's assessment of threats to the financial system is a collaborative process, driven by review of the best information available and expertise from FSOC members and their agencies and staff. The FSOC has a number of tools to address threats to financial stability, including its authority to designate non-bank financial companies and financial market utilities for enhanced prudential standards and supervision. The FSOC also has the ability to provide for more stringent regulation of a financial activity by issuing recommendations to financial regulatory agencies to apply new or heightened standards and safeguards. In addition, FSOC members have many tools at their disposal to address vulnerabilities and threats, owing to their involvement in supervision and regulation, consumer and investor protection, and market and infrastructure oversight.
- In the *EU*, the European Systemic Risk Board (ESRB), the macroprudential authority for the EU, published in January 2012 a set of recommendations addressed to the EU Member States on the macroprudential mandate of national authorities.⁵⁴ Under the recommendation, Member States should designate an authority in national legislation to conduct macroprudential policy, taking due consideration of national institutional frameworks. Further, the ESRB recommended that EU Member States bestow the macroprudential authority with the powers to conduct macroprudential policy on its own initiative or as a follow-up to recommendations or warnings from the ESRB. The national authority should also have full access to all the necessary statistical information and policy instruments. EU Member States are also called upon to confer on the authority the necessary independence for it to fulfil its tasks, to ensure an adequate level of accountability and to reserve the maximum of transparency. The EU Member States are required to communicate their intentions with respect to implementation by June 2012 and to take the necessary actions before 1 July 2013.

The BCBS published in May 2012 two working papers arising from its Research Task Force Transmission Channel project that help to build the knowledge base in the area of macroprudential policies. The first working paper, *The policy implications of transmission channels between the financial system and the real economy*, analyses the link between the real economy and the financial sector, and channels through which the financial system may transmit instability to the real economy.⁵⁵ The second working paper, *Models and tools for macroprudential analysis*, focuses on the methodological progress and modelling advancements aimed at improving financial stability monitoring and the identification of systemic risk potential.⁵⁶ The second working paper, in particular, discusses analytical methods used to measure the impact of macro-financial shocks on the real economy; developments in modelling financial sector liquidity risk including the potential for contagion; methods for measuring the potential for systemic risk; and bank behavioural responses to changing central bank and macroprudential policies and macroeconomic conditions.

⁵⁴ http://www.esrb.europa.eu/news/pr/2012/html/pr120116_1.en.html

⁵⁵ http://www.bis.org/publ/bcbs_wp20.pdf

⁵⁶ http://www.bis.org/publ/bcbs_wp21.pdf

10. Strengthening adherence to international financial standards

The FSB, in collaboration with the SSBs, established a framework in October 2011 – the CFIM – for monitoring and reporting on the implementation of the G20 financial reforms.⁵⁷ The CFIM was subsequently endorsed by the G20 Leaders at the Cannes Summit as a way to “intensify our monitoring of financial regulatory reforms, report on our progress and track our deficiencies”. The framework highlights priority areas⁵⁸ that will undergo more intensive monitoring and detailed reporting via periodic progress reports and peer reviews. It also outlines a process to facilitate ongoing consultation and collaboration between the FSB and the SSBs by clarifying their respective roles in monitoring national implementation efforts. This consultation process is important to ensure that the plans for implementation monitoring are consistent with G20 reporting requirements as described in the CFIM.

The FSB has undertaken a number of steps since the adoption of the CFIM in October 2011 to put it in operation. In priority areas where the policy development work is largely completed, the FSB is working with relevant SSBs to ensure that the scope and approach of implementation monitoring and reporting are sufficiently comprehensive and rigorous to satisfy G20 and FSB information requirements.⁵⁹ This is complemented by the FSB’s IMN, which is tasked with collecting information from national authorities and reporting on the implementation of financial reforms in other areas. All implementation progress reports for the priority areas and the completed IMN national/regional responses on the progress in other areas are available on the FSB website.⁶⁰

In addition to periodic progress reports, the FSB monitors the implementation and effectiveness of international financial standards and policies via its peer review programme. Peer reviews are an important institutional mechanism to promote complete and consistent implementation and are a means of fostering a race to the top by FSB member jurisdictions. They provide an opportunity for FSB members to engage in dialogue with their peers and to share lessons and experiences. The FSB completed in December 2011 a review of experience to date with FSB peer reviews. The review identified lessons and recommended certain refinements to the functioning of the programme in order to further enhance its effectiveness and value-added, which have been incorporated in the *Handbook for FSB Peer Reviews*.⁶¹

Since the Cannes Summit, the FSB has completed a thematic peer review on deposit insurance systems (DISs) using the BCBS-IADI *Core Principles for Effective Deposit Insurance Systems* as a benchmark. The review confirmed the importance and necessity of an effective DIS and noted that the crisis resulted in greater convergence in practices across jurisdictions and an emerging consensus about appropriate DIS design features. While the reviewed DISs in FSB member jurisdictions were found to be broadly consistent with the

⁵⁷ http://www.financialstabilityboard.org/publications/r_111017.pdf

⁵⁸ The current list of priority areas agreed by the FSB comprises the Basel II/II.5/III framework; OTC derivative market reforms; compensation practices; policy measures for G-SIFIs; resolution frameworks; and shadow banking.

⁵⁹ Given the status of progress in each priority area, there are three stand-alone implementation progress reports for the Los Cabos Summit: Basel II/II.5/III framework; OTC derivative market reforms; and compensation practices. The findings from these reports are described in different parts of this document.

⁶⁰ http://www.financialstabilityboard.org/activities/implementation_monitoring/mr_201206.htm

⁶¹ http://www.financialstabilityboard.org/publications/r_120201.pdf

standard, there remain some areas where there appear to be divergences from (or inconsistencies with) the *Core Principles*. In some areas, more precise guidance may be needed to achieve effective compliance or to better reflect leading practices. The report contains a number of recommendations to address these issues.

The recommendations of past thematic peer reviews are also leading to concrete follow-up activities by relevant parties. In the case of compensation practices, an ongoing monitoring mechanism has been established by the FSB to follow up on remaining gaps and impediments to full implementation as well as on actions taken in response to the peer review's recommendations (see section 8). In the case of risk disclosures, an FSB roundtable with relevant market participants was organised in December 2011 and the Enhanced Disclosure Task Force (EDTF) will take forward the work to identify leading practices and develop principles for risk disclosures. In response to the recommendations from the peer review of residential mortgage underwriting practices, the FSB has issued an international principles-based framework for sound underwriting in this area.⁶² Finally, in the case of the peer review on deposit insurance systems, the IADI is updating its guidance that pre-dates the financial crisis and developing additional guidance in certain areas covered by the *Core Principles*.

The FSB has also recently completed the country peer reviews of Canada and Switzerland. Three more peer reviews – thematic reviews of risk governance and resolution regimes as well as the country review of South Africa – will be completed by early 2013. All completed peer review reports are available on the FSB website.⁶³

FSB members' adherence to international standards is essential to reinforce the credibility of the FSB's efforts to strengthen adherence by all countries and jurisdictions. To lead by example, member jurisdictions have agreed to publish information on the commitments they made under the *FSB Framework for Strengthening Adherence to International Standards*.⁶⁴

In March 2010, the FSB launched an initiative to encourage the adherence of all jurisdictions to regulatory and supervisory standards on international cooperation and information exchange, including by identifying non-cooperative jurisdictions and assisting them to improve their adherence. The initiative responded to a call by the G20 Leaders at their April 2009 Summit for the FSB to develop a toolbox of measures to promote adherence to prudential standards and cooperation. The FSB has prioritised about 60 jurisdictions for evaluation, including all 24 FSB member jurisdictions and non-FSB jurisdictions that rank highly in financial importance. To recognise the progress that jurisdictions have made toward addressing weaknesses in international cooperation and information exchange, and to incentivise improvements by those jurisdictions not cooperating fully, the FSB published on 2 November 2011 information on the jurisdictions evaluated to date.⁶⁵ Since then, China and Saudi Arabia have demonstrated, through the results of their IMF-World Bank assessments, sufficiently strong adherence to the relevant standards.⁶⁶ The FSB will publish updated

⁶² http://www.financialstabilityboard.org/publications/r_120418.pdf

⁶³ http://www.financialstabilityboard.org/list/fsb_publications/tid_141/index.htm

⁶⁴ See http://www.financialstabilityboard.org/publications/r_100109a.pdf.

⁶⁵ http://www.financialstabilityboard.org/publications/r_111102.pdf

⁶⁶ This level of adherence is consistent with the level of adherence of the jurisdictions listed in Table 1 of the 2 November 2011 FSB statement.

information in November 2012 on all jurisdictions that have been evaluated under the initiative.

11. Strengthening FSB governance

11.1 Strengthening FSB's capacity, resources and governance

To meet the mandate given by the G20 Leaders at the Cannes Summit to strengthen the FSB's capacity, resources and governance, including its establishment on an enduring organisational footing while preserving its strong and well-functioning links with the BIS, the FSB established a High-Level Working Group on FSB Capacity, Resources and Governance. The FSB has submitted its recommendations along with a revised FSB Charter to the Los Cabos Summit for G20 Leaders' endorsement.⁶⁷

The main recommendations of the Working Group include:

- (i) preserving the FSB's flexible, responsive, member-driven, multi-institutional and multi-disciplinary character, active involvement of senior-level officials from finance ministries, central banks and supervisory authorities, and nexus between the political level and regulatory policy making of the SSBs;
- (ii) pursuing a gradual approach to the institutionalisation of the FSB by establishing it as an association under the Swiss law to provide it a legal personality, with the functional immunities needed for its effective operation as a policy making body while maintaining strong and well-functioning links with the BIS;
- (iii) strengthening its continuing role in reducing the likelihood of financial crises through vulnerability assessment, effective and forward looking coordination of international standard setting, reviewing regulatory policies within a macroprudential perspective and comprehensive monitoring of members' implementation of international financial standards and agreed G20 and FSB commitments and recommendations;
- (iv) as needed to regulatory gaps that pose risk to financial stability, developing or coordinating development of standards and principles, in collaboration with the relevant SSBs and other stakeholders, as warranted, in areas which do not fall within the functional domain of another international standard-setting body, or on issues that have cross-sectoral implications, in line with the current practice; and
- (v) improving its governance, transparency and accountability arrangements through amendments to its charter, setting up Rules of Procedure and establishing a Standing Committee on Budget and Resources for effective financial governance.

The implementation of the recommendations would commence shortly after the G20's endorsement.

⁶⁷ http://www.financialstabilityboard.org/publications/r_120619c.pdf

As part of the ongoing governance reforms, in January 2012, the FSB also reconstituted its Steering Committee to rebalance its composition in terms of institutional and geographic representation.

11.2 Increasing outreach through the FSB regional consultative groups

In response to the G20 Leaders' call at the Toronto Summit for the FSB to expand and formalise its outreach beyond its membership, the FSB established in 2011 Regional Consultative Groups (RCGs) for the Americas, Asia, the Commonwealth of Independent States, Europe, Middle East & North Africa, and Sub-Saharan Africa. The RCGs bring together financial sector authorities from FSB member and non-member jurisdictions to exchange views on vulnerabilities affecting financial systems and on initiatives to promote financial stability.

Membership in the RCGs includes ministries of finance, central banks and supervisory authorities in 65 FSB non-member jurisdictions and their counterparts in FSB member jurisdictions. All of the RCGs have met at least once and some have set up working groups to study financial stability issues of interest to their respective region. RCGs have presented the output of the working groups to the FSB Plenary as a part of the consultative feedback provided by non-FSB members.

12. Other issues

12.1 Addressing data gaps

In the global financial crisis that began in 2007, the lack of timely, accurate and consistent information on large systemically important banks has proved very costly. The critical initiatives underway to reform and strengthen the financial system all require better data, be it to support more intensive supervision, to identify risk concentrations and the build-up of systemic risk, or to assist authorities in crisis situations. In this regard, the FSB Data Gaps Project aims to provide a consistent framework to pool and share relevant data on the major bilateral linkages between large international financial institutions, and on their common exposures to and funding dependencies on countries, sectors and financial instruments.

As part of a wider initiative to improve data to support financial stability, the FSB was tasked with improving the availability, quality and consistency of data on major global financial institutions and financial inter-linkages.⁶⁸ To take this forward, the FSB has set up a working group of experts from national authorities and international institutions, with the mandate to develop proposals for a new common data template for globally systemic institutions. The working group is conducting extensive preparatory work, including a thorough examination of legal issues on the sharing of data and a continued consultation with the industry on the common template.

The FSB is taking an incremental approach for the FSB Data Gaps Project with three distinct phases characterised by a progressive increase in the granularity of the data and in the sharing

⁶⁸ http://www.financialstabilityboard.org/publications/r_091107e.pdf

of information.⁶⁹ The FSB has approved the implementation of the initial phase of the project (“Phase 1”) for a start in March 2013. This phase foresees the creation of a central hub to be hosted by the BIS for the storage and management of data collected and the sharing of this information among relevant supervisory authorities. Implementation work for Phase 1 is on track, both on the data side, with the planned finalisation of the Phase 1 template very shortly, and on the governance side, where key principles underpinning exchange of information in Phase 1 have been developed.

Regarding the next phases of the project, preparatory work is ongoing on data templates and on the feasibility of wider data sharing. The FSB will decide on the implementation of Phases 2 and 3 after this preparatory work is completed, as there is no automaticity between Phases 1, 2 and 3.

12.2 Identifying unintended consequences of regulatory reforms on EMDEs

In February 2012, the G20 Finance Ministers and Central Bank Governors asked the FSB to coordinate, with the IMF and World Bank, a study to identify the extent to which the agreed regulatory reforms may have unintended consequences for emerging market and developing economies (EMDEs). The intent of the study is not to re-open recent internationally agreed regulatory reforms but to better understand the possible effects of those reforms in the context of broader post-crisis developments on EMDEs. National authorities from EMDEs that are members of the FSB or of an FSB RCG were surveyed for this purpose, while an FSB Review Group comprising FSB members and co-chairs of RCGs provided guidance on the selection and analysis of the issues included in the study as well as on its main messages.

There is widespread support among EMDEs for the objectives of the agreed reforms. At the same time, there is a broad range of views regarding the extent to which these reforms are having, or expected to have, an impact on their financial systems. This heterogeneity in perspectives can be attributed to the early stage of implementation of the reforms and to the diversity of EMDE financial systems, which give rise to different considerations and concerns. Those respondents that did identify unintended consequences focused on a few key areas: the Basel III capital and liquidity framework; policy measures – including resolution frameworks – for G-SIFIs; and OTC derivatives reforms. Some respondents also identified other national/regional regulatory reforms – such as higher capital requirements by the European Banking Authority (EBA) for large banks in the EU, and the Volcker Rule in the US – as giving rise to spillovers and/or extraterritorial effects that may lead to unintended consequences.

A number of the concerns raised by EMDEs relate to cross-border effects and perceived home bias in the design or implementation of reforms. Several of the key concerns have also been raised by advanced economies and are being addressed by relevant international bodies during policy development and implementation. The responses reflect some implementation challenges for EMDEs and raise the issue of clearly identifying intended versus unintended consequences. It is too early to assess fully the materiality and persistence of the effects of

⁶⁹ The three phases are: Phase 1 (pooling existing data on exposures and continue sharing them among supervisors); Phase 2 (collection of new data on funding and extension of sharing to macroprudential authorities) and Phase 3 (significant increase in granularity of data for exposures and funding and extension of sharing to international financial institutions and host authorities of G-SIBs).

regulatory reforms on EMDEs, and it would be useful to continue to monitor the effects of those reforms as well as to share experiences and implementation lessons. The findings also highlight the importance of ongoing dialogue and cooperative relationships among national authorities from EMDEs, SSBs and international financial institutions in order to facilitate the mitigation of unintended consequences from the implementation of agreed reforms in EMDEs.

12.3 Enhancing consumer finance protection

The global financial crisis demonstrated the need to strengthen consumer protection policies and frameworks to ensure that the use (or misuse) of individual financial products do not become a source of financial instability. A significant contributor to that crisis was poorly underwritten residential mortgages, which often represent the largest component of household and consumer debt. In response, a number of FSB members have encouraged prudent underwriting practices to limit the risks that mortgage markets pose to financial stability and to better safeguard consumers and investors. The FSB *Principles for Sound Residential Mortgage Underwriting Practices* released in April 2012 provide a framework for jurisdictions to set minimum acceptable underwriting standards.⁷⁰ After providing sufficient time for implementation, the FSB will conduct a thematic review to assess progress made in implementing the framework. The Principles will assist FSB members in their efforts to improve financial stability and prudential standards. They also refer to consumer protection issues that contribute to these objectives, but the Principles are not intended to be a statement of consumer protection standards. Jurisdictions will want to adopt the consumer protection standards that are appropriate to them, including the Organisation for Economic Cooperation and Development's (OECD) *High-level Principles on Financial Consumer Protection* which were endorsed by the G20 Leaders at the Cannes Summit.⁷¹

The OECD high-level principles are designed to help its member jurisdictions and other interested economies to enhance financial consumer protection. Several FSB members have already self-assessed their consumer protection frameworks against these high-level principles and found that they are in line with the recommendations (e.g. Australia, Canada, and France). However, an even larger number of jurisdictions would like additional information to support their efforts toward implementation, particularly on the following principles:

- Disclosure and Transparency (principle 4)
- Responsible Business Conduct of Financial Services Providers and Authorised Agents (principle 6)
- Complaints Handling and Redress (principle 9)

The OECD, in collaboration with the FSB and SSBs, have developed an action plan to identify, within 24 months, a set of relevant approaches to support the effective implementation of the high-level principles.

To help advance consumer finance protection efforts, the FSB report on consumer finance protection with a particular focus on credit endorsed by G20 Leaders at the Cannes Summit

⁷⁰ http://www.financialstabilityboard.org/publications/r_120418.pdf

⁷¹ <http://www.oecd.org/dataoecd/58/26/48892010.pdf>

set out three options, including supporting a global platform for consumer protection authorities to exchange views on experiences as well as lessons learnt from the crisis to help strengthen consumer protection policies across the FSB membership and beyond.⁷² In this regard, the importance of the Financial Consumer Protection Network (FinCoNet) as a global network of market conduct financial authorities was recognised by the G20 Finance Ministers and Central Bank Governors in April 2012. FinCoNet is currently refining its mandate to enhance its legitimacy as the international organisation of consumer protection authorities.

These efforts will help maintain the momentum toward strengthening consumer finance protection frameworks as several jurisdictions are considering significant changes to their frameworks, including strengthening the institutional arrangements for consumer protection authorities (e.g. China), legislative changes (e.g. Korea) as well as enhancements to existing regulatory frameworks (e.g. Switzerland).

⁷² http://www.financialstabilityboard.org/publications/r_111026a.pdf