

To G20 Finance Ministers and Central Bank Governors

Financial Reforms – Progress on the Work Plan for the Antalya Summit

In February in Istanbul, we agreed the following priorities for the FSB's G20 financial regulation agenda:

- full, consistent and prompt implementation of agreed reforms;
- finalising the design of remaining post-crisis reforms; and
- addressing new risks and vulnerabilities.

These priorities support the focus of the Turkish G20 Presidency on the three "I's" – Implementation, Investment and Inclusion by

- monitoring, reporting and encouraging implementation of the agreed reforms;
- addressing new risks to the financial system that could hinder its ability to finance investment in the real economy; and
- tackling issues such as financial misconduct that can inhibit financial inclusion.

This letter provides an update on progress at last month's FSB Plenary meeting in Frankfurt.

FULL, CONSISTENT AND PROMPT IMPLEMENTATION OF AGREED REFORMS

Full, consistent and prompt implementation remains essential in order to maintain an open and resilient global financial system. To streamline and enhance reporting to the G20, the FSB Plenary agreed an outline of our first annual consolidated report on the implementation of the regulatory reforms and their effects, to be delivered to the Antalya Summit and published.

The annual report will help underline those areas where the support of ministers is required to maximise the benefit from previously endorsed policy actions.

The report will highlight progress, good practice and shortcomings and evaluate where there are either inconsistencies in implementation or unintended consequences that need to be addressed. Over time, these annual reports will enable the G20 to assess whether its reforms are achieving their intended results in an effective and efficient manner.

National jurisdictions can help by contributing domestic evaluations of effects and unintended consequences of regulatory change.

This report will also incorporate the outcomes from the FSB's peer reviews, those of the standard setting bodies, our impact assessments, and analysis of the effects of reforms on long-term finance and on emerging market economies.

One such peer review, which the FSB will publish shortly, covers members' implementation of stronger frameworks and approaches for supervision of systemically important banks, aimed at delivering a more intensive and effective approach to supervision.

FINALISING THE REMAINING POST-CRISIS REFORMS

My February letter outlined further work this year on the international design of reforms in three areas: completion of the capital framework for banks; measures to help end too-big-to-fail; and initiatives to make derivatives markets safer. I reported in February on the actions being taken by the Basel Committee in the first of these areas, and will focus in this letter on the additional steps agreed in the second and third areas.

Ending too-big-to-fail

The FSB is reviewing the consultation responses on the proposal for total loss absorbing capacity (TLAC) published last November, and the various TLAC impact assessment studies are well underway. While there are a number of issues to be addressed, work is on track for the FSB to finalise the international standard by the Antalya Summit. We look to Ministers and Governors to support us in delivering on this commitment to Leaders.

The FSB also reviewed steps to finalise policy measures for statutory and contractual approaches to cross-border recognition of resolution actions following the recent public consultation. As part of this initiative, work is underway to promote broad adoption of contractual recognition clauses to make temporary stays in respect of early termination rights effective in a cross-border context.

We are also taking further steps this year to end too-big-to-fail for financial entities other than banks.

The International Association of Insurance Supervisors (IAIS) will, by Antalya, finalise higher loss absorbency requirements for global systemically important insurers.

The FSB published in March a second consultative paper on methodologies to identify non-bank, non-insurer global systemically important institutions.

The growing use of CCPs for standardised OTC derivatives transactions is reducing systemic risks, but we must also ensure that CCPs themselves are not too big to fail.

As you requested at your meeting in February, the FSB is pursuing with CPMI, IOSCO and BCBS a coordinated work plan to promote CCP resilience, recovery planning and resolvability. Key elements include:

- evaluating existing measures for CCP resilience, including loss absorption capacity, liquidity and stress testing;
- conducting a stock-take of existing CCP recovery mechanisms, including loss allocation tools, and considering whether there is a need for more granular standards;
- reviewing existing CCP resolution regimes and resolution planning arrangements, and considering whether there is a need for more granular standards or for additional prefunded capital and liquidity resources in resolution; and
- analysing the interconnections between CCPs and the banks that are their clearing members, and potential channels for transmission of risk.

Making derivatives markets safer

As I reported in February, the G20 needs to ensure that the extensive work to date to introduce comprehensive trade reporting of OTC derivative markets is truly effective in providing authorities with an overview of systemic risks and reducing the opacity of these markets. To that end, the FSB has agreed a work plan to take forward, with CPMI and IOSCO, the standardisation and aggregation of OTC derivatives trade reporting data. This will identify where legal and other blockages to the reporting, sharing and aggregation of key information regarding trades need to be removed. In some jurisdictions, ministerial action may be required.

ADDRESSING NEW RISKS AND VULNERABILITIES

Following your meeting in Istanbul, the FSB has developed work programmes to address two specific emerging vulnerabilities: market-based finance and misconduct.

Risks stemming from market-based finance

The ongoing disconnect between risk-taking in financial markets and developments in real economies continues to pose the threat of disorderly adjustments in financial markets.

While the trend towards greater market-based intermediation through asset management entities is welcome and should contribute to the overall resilience of the financial system by providing alternative sources of funding, it is important to ensure that any financial stability risks are properly understood and managed.

With net credit creation largely reliant on bond finance, and emerging markets tripling annual issuance of international bonds since the crisis, there is a risk that a disorderly portfolio reallocation could generate a pronounced tightening of credit conditions for the real economies across the G20.

Against this backdrop, the FSB is prioritising work to understand and address vulnerabilities in capital market and asset management activities. This will comprise two linked projects. The first will examine the likely near-term risk channels and the options that currently exist for addressing these. The second will consider the longer-term development of these markets and whether additional policy tools should be applied to asset managers according to the activities they undertake with the aim of mitigating systemic risks.

Misconduct risks

As discussed in Istanbul, the scale of misconduct in some financial institutions has risen to a level that has the potential to create systemic risks.

To address misconduct risks, the FSB has agreed a work plan that will examine:

- whether the reforms to incentives, for instance to risk governance and compensation structures, are having sufficient effect on reducing misconduct and whether additional measures are needed to strengthen disincentives to misconduct;
- the progress of ongoing reforms to benchmarks, and whether steps are needed to improve global standards of conduct in the fixed income, commodities and currency markets; and
- together with the World Bank and other relevant bodies, the extent of potential withdrawal from correspondent banking, its implications for financial exclusion, as well as possible steps to address this issue.

EMERGING MARKET AND DEVELOPING ECONOMIES (EMDES)

With your support, the FSB has taken further steps to ensure that the issues of most importance to EMDEs are identified and addressed. When the FSB was established in 2009, participants from all G20 jurisdictions were included as founder members. And our work has benefited greatly from the global perspective that this has brought.

To reflect the steady increase in the importance of EMDEs, at Frankfurt the FSB welcomed five new institutions as Plenary members – the ministries of finance or treasuries for Argentina, Indonesia, Saudi Arabia and Turkey and the South African Reserve Bank. Increased representation for emerging markets has delivered a key objective of the FSB's 2014 review of the structure of its representation.

Ahead of the Plenary meeting, the FSB held an Emerging Market Forum to discuss financial stability issues of particular relevance to these jurisdictions. The discussion centred on implementation of agreed reforms (including proportionality and sequencing), notably for Basel III, OTC derivative reforms and resolution. Discussions covered both implementation by EMDEs themselves and spill-overs from the way reforms are being implemented in advanced economies. We also discussed experience with macro-prudential policies in emerging markets, concerns about reduced availability of correspondent banking services, and the continued need to make local capital markets deeper and more resilient, as well as sovereign debt restructuring processes. The FSB, with the standard-setting bodies and international financial institutions, will now consider how they can best incorporate the points raised into their work plans.

CONCLUSION

Under the G20's leadership, the FSB has a full and challenging agenda to build a resilient, open, and trusted global financial system that supports the G20's ultimate objective of strong, sustainable and balanced growth for all countries.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'M. Carney', with a long horizontal flourish extending to the right.

Mark Carney