FSB FINANCIAL STABILITY BOARD

THE CHAIR

4 April 2019

To G20 Finance Ministers and Central Bank Governors

I am honored to serve as FSB Chair and thank the G20 for the confidence they have placed in me. Vice Chair Knot and I are committed to working together with G20 Ministers and Governors to continue the important work to identify key vulnerabilities, to promote coordinated policies when needed, and to monitor the implementation and to assess the effectiveness of global financial regulatory reforms.

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Ten years after the onset of the financial crisis, the Financial Stability Board (FSB) is entering a new phase where our priorities are shifting from developing post-crisis reforms to assessing new vulnerabilities and evaluating the effectiveness of the regulatory reforms put in place.

The G20 financial reforms launched in 2009 to address the fault lines revealed by the financial crisis are nearly complete. The post-crisis regulatory framework, developed under the leadership of first Mario Draghi and then Mark Carney and in coordination with a variety of international standard-setting bodies, has made the global financial system safer, simpler, and fairer.

That said, G20 Finance Ministers and Central Bank Governors are meeting at a time with increasing downside risks to global growth and high public and corporate debt levels. Completing and implementing the reforms in the four core areas that form the foundation of the FSB's reform program – building resilient financial institutions; ending too-big-to-fail; enhancing resilience of non-bank financial intermediation; and making derivatives markets safer – remain as relevant now as they were in the aftermath of the crisis.

Yet promoting a stable global financial system that supports sustainable growth goes beyond completing the reform agenda. It also calls for evaluating the effects of the reforms put in place, to ensure that these achieve the intended objectives in terms of financial resilience in an efficient manner, while avoiding unintended consequences. And, as importantly, financial stability requires continued vigilance concerning new and emerging vulnerabilities in the financial system.

The FSB's priorities under this year's Japan G20 Presidency reflect the FSB's pivot to assessing new potential risks to financial stability and the effects of the reforms put in place. The rest of this letter will highlight important work currently underway in the FSB.

Addressing new and emerging vulnerabilities in the financial system

Identifying new and emerging vulnerabilities

The FSB will continue to scan the horizon to identify and assess emerging risks through regular discussion by its members of macro-financial developments, as well as through the bi-annual Early Warning Exercise conducted jointly with the International Monetary Fund (IMF). To further strengthen the effectiveness of its vulnerabilities work, the FSB will develop an explicit surveillance framework.

The core of the financial system, including international banks, is considerably more resilient than it was a decade ago. Potential vulnerabilities in the financial system persist, however, and in some cases have built up further. Loosening lending standards, elevated asset values, and high corporate and public debt call for particular vigilance.

The Standing Committee on Assessment of Vulnerabilities continues to monitor and assess potential vulnerabilities to global financial stability, so that actions to address them can be identified, where needed. As part of this work, over the coming months it is evaluating the global pattern of exposures to collateralized loan obligations and leveraged loans, so as to improve understanding of the global financial stability risks that these may entail.

At the date of writing this letter it is not known whether the UK will leave the EU without a withdrawal agreement having been agreed. The possibility of a disruptive Brexit therefore remains. Authorities and firms have taken steps to address possible financial stability risks, though some disruption to cross-border services remains possible. A disruptive Brexit could represent an adverse macroeconomic shock, which could be accompanied by significant market volatility. The FSB is monitoring developments and if necessary will advise G20 Ministers and Governors on risks, should they crystallize.

Assessing the financial stability implications of structural changes in the financial system

The FSB will also continue to assess the impact of evolving market structures and of technological innovation on global financial stability. This includes the resilience of financial markets in stress, the implications of the growth of non-bank financial intermediation and operational issues such as cyber risks.

The growth in non-bank financing represents a welcome increase in the diversity of the sources of finance supporting economic activity, provided that such financing is resilient. The FSB continues to monitor closely the developments and risks in non-bank financial intermediation. The FSB's latest annual *Global Monitoring Report on Non-Bank Financial Intermediation* documents that non-bank financial assets continue to grow, and are now just under half of total global financial assets. It is therefore important to analyze the potential financial stability implications of different types of non-bank finan ce and how such financing flows will behave.

Technological innovation, a key focus of the Japanese G20 Presidency, has the potential to change significantly the structure and functioning of the global financial system. While such changes hold the promise of substantial economic benefits, they may also give rise to new risks. The FSB continues to monitor the financial stability implications of crypto-assets and is currently working to identify possible regulatory gaps in this area. In addition, we are analyzing broader financial stability implications of technological innovation, such as the entry of large technology firms into finance and the growth in decentralized financial technologies.

- For this April G20 meeting, the FSB delivered a directory of regulators on crypto-assets.
- For the June G20 meeting, the FSB will deliver a report on the financial stability implications of decentralized financial technologies for the governance of financial regulation.

The FSB will continue to contribute to work to enhance cyber resilience, supporting the Japanese G20 Presidency's focus on financial innovation. Building on its 2017 stock take of regulatory and supervisory cyber security practices and its 2018 cyber lexicon, during 2019 and 2020 the FSB will develop and report on effective practices relating to a financial institution's response to, and recovery from, a cyber incident.

- For the June G20 meeting, a progress report will be delivered on the development of effective practices for cyber incident response and recovery.

Finalizing and operationalizing post-crisis reforms

Completing the remaining elements of reforms

The FSB will work with standard-setting bodies to complete the few remaining reform items.

Work in the area of capital standards is almost complete. The remaining work focuses on the insurance sector. In 2019, the International Association of Insurance Supervisors (IAIS) will finalize the development phase of the Insurance Capital Standard for its use during a five-year monitoring period and the Common Framework for the Supervision of Internationally Active Insurance Groups. The IAIS will also finalize and adopt a holistic framework to mitigate systemic risk in the insurance sector.

As regards policies addressed to ending "too-big-to-fail", FSB will continue its work on technical and operational issues that arise in resolution and will address issues relating to systemic risk in central counterparties (CCPs). In 2019, the FSB will work on providing additional guidance on the adequacy of financial resources for CCPs to support resolution and the treatment of CCP equity in resolution. This work will be completed in 2020.

On derivative markets, making the best use of trade reporting data for financial risk analysis and management remains an important task. To this end, the FSB will continue to work with standard-setting bodies to improve effectiveness of trade reporting. In 2019, the FSB will be finalizing governance arrangements for the unique transaction identifier (UTI) and unique

product identifier (UPI) and expects to identify one or more UPI service providers by mid-2019. This would prepare the FSB for consideration in 2020 of the potential development of a global aggregation mechanism for trade reporting.

Work on addressing structural vulnerabilities in asset management is ongoing. The International Organization of Securities Commissions (IOSCO) will continue to work on operationalizing FSB recommendations to address structural vulnerabilities from asset management activities, including the finalization of consistent leverage measures for funds. Looking beyond 2019, once implementation of the FSB recommendations has progressed, IOSCO and FSB will assess whether these recommendations have been implemented effectively, and the FSB will report back to the G20.

Supporting full, timely and consistent implementation

The full, timely and consistent implementation of agreed reforms is critical. The FSB, in collaboration with standard-setting bodies, will continue to work on implementation monitoring and will also continue its program of peer reviews that are critical to achieve the FSB's goal of greater financial resilience. In 2019, it will publish peer reviews on bank resolution planning and on the promotion of implementation of the global Legal Entity Identifier, as well as a monitoring report of conformance with the total loss absorbing capacity (TLAC) standard.

- For the June G20 meeting, the FSB will provide an update on the status of FSB members' implementation of reforms in priority areas, and for the October G20 meeting the FSB will deliver the fifth "Annual Report on Implementation and Effects of the G20 Financial Regulatory Reforms".
- For the June G20 meeting, the FSB will deliver a progress report on implementing its recommendations on remittance firms' access to banking services.
- For the June G20 meeting, the FSB will deliver the latest status report by the Task Force on Climate-related Financial Disclosures on the implementation of its recommendations.

Evaluating the effects of reforms

Evaluating the effects on SME financing and Too-Big-To-Fail policies on banks

As its policy work on the post-crisis regulatory framework draws to a close, the FSB is placing increasing emphasis on the rigorous evaluation of the effects of the agreed G20 reforms. The objective is to assess whether reforms are operating as intended, and to identify and deliver adjustments where appropriate, without compromising on the agreed level of resilience.

In 2018, the FSB completed the first two evaluations, on infrastructure finance and incentives to centrally clear over-the-counter derivatives, under its framework for evaluating the effects of the reforms delivered in 2017. These two evaluations show how the FSB can coordinate work to address issues spanning the broad set of G20 financial reform objectives and sectors. They also show the importance of a robust evidence-based approach that uses state of the art techniques.

The FSB is currently working on two evaluations. One, to be completed during this year's G20 Presidency, examines the effects of reforms on small and medium-sized enterprise financing. The other, which has just started, evaluates the effects of too-big-to-fail reforms in the banking sector.

- For the June G20 meeting, the FSB will deliver, and publish for public consultation, our evaluation on the "Effects of the financial regulatory reforms on small and medium-sized enterprises".

Reinforcing an integrated and resilient global financial system

Identifying and addressing possible sources of market fragmentation that may be harmful to financial stability is important for maintaining an open and resilient financial system. The FSB, alongside standard-setting bodies, is exploring issues around market fragmentation, supporting the Japanese G20 Presidency's priority to address this topic. The issues being explored include the conditions under which fragmentation arises and its potential impact, as well as effective approaches to tackle fragmentation.

- For the June G20 meeting, the FSB will deliver a report detailing its analysis including recommendations for further work on market fragmentation.

Reinforcing outreach to stakeholders

Financial stability vulnerabilities transcend the G20 and are broadly global in nature. Reaching out beyond its membership is therefore key for the FSB to achieve its mandate of promoting global financial stability. To strengthen the FSB's outreach to non-member jurisdictions, the FSB is conducting a review of how to improve the effectiveness of the FSB's six regional consultative groups, which are important networks for exchanging information and views on financial stability issues.

The FSB is also committed to improve communication and transparency with other external stakeholders, to increase understanding of the FSB's work and facilitate greater input from a wider array of stakeholders. The FSB is taking a number of steps to this end: standardizing its public consultation process; improving accessibility of information provided to the general public, including through the publication of a detailed work program; and a structured approach towards stakeholder involvement in specific FSB initiatives.

Conclusion

While much progress has been made since the Global Financial Crisis, the recent build-up of vulnerabilities in a number of areas reminds us that we cannot be complacent. The FSB will therefore work expeditiously to finalize post-crisis reforms, to improve our ability to identify and respond to financial vulnerabilities in a timely manner, and to monitor the implementation and assess the effectiveness of financial reforms. Through these determined efforts to promote a

resilient global financial system, the FSB remains committed to contributing to the G20's goal of strong, sustainable, balanced and inclusive growth.

Yours sincerely

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