FSB FINANCIAL STABILITY BOARD

THE CHAIR

13 March 2018

To G20 Finance Ministers and Central Bank Governors

G20 Finance Ministers and Central Bank Governors are meeting against a backdrop of strong and balanced global growth. This momentum is underpinned by a resilient global financial system that is the product of determined efforts by the G20 and FSB over the past decade.

The FSB's priorities under the Argentine Presidency are designed to build on that strong foundation to reinforce the G20's objective of strong, sustainable and balanced growth through:

1. Vigilant monitoring to identify, assess and address new and emerging risks;

2. Disciplined completion of the G20's outstanding financial reform priorities;

3. Pivoting focus from new policy development towards evaluating policies that have been implemented to ensure the reform programme is efficient, coherent and effective, and addressing any unintended consequences; and

4. Optimising how the FSB works to maximise its effectiveness by capitalising on its advantages as an efficient and responsive organisation, led by and dependent on the contributions and consensus of its members.

1. VIGILANT MONITORING OF EMERGING RISKS

The FSB regularly scans the horizon to identify and assess emerging risks through the bi-annual Early Warning Exercise conducted jointly with the IMF; candid and timely discussions of macro-financial developments at its Steering Committee and Plenary; expert member analysis; and structured analysis of trends and developments.

The recent sharp rise in financial market volatility from record lows crystallised some of the risks which the FSB and member authorities have been actively monitoring and addressing (including in a number of domestic stress tests). The proximate triggers of the short period of market turbulence in February were changing expectations of global growth and the inflation outlook, with associated implications for the evolution of market rates and sustainability of asset prices. Despite the size of some market moves, contagion was limited, and core markets and systemic infrastructure operated effectively throughout.

Such resilience of the financial system to shocks, whatever their source, underscores the importance of G20 reforms. Large banks are considerably stronger, more liquid and more focused. They are now subject to greater market discipline as a consequence of globally-agreed standards to end too-big-to-fail. A series of measures are eliminating toxic forms of shadow

banking and are transforming the remaining activity into resilient market-based finance. Reforms to over-the-counter derivative markets are replacing a complex and dangerous web of exposures with a more transparent and robust system that better serves the real economy.

Crypto-assets

Responding to the concerns of members, the FSB has undertaken a review of the financial stability risks posed by the rapid growth of crypto-assets.

The FSB's initial assessment is that crypto-assets do not pose risks to global financial stability at this time. This is in part because they are small relative to the financial system. Even at their recent peak, their combined global market value was less than 1% of global GDP. In comparison, just prior to the global financial crisis, the notional value of credit default swaps was 100% of global GDP. Their small size, and the fact that they are not substitutes for currency and with very limited use for real economy and financial transactions, has meant the linkages to the rest of the financial system are limited.

The market continues to evolve rapidly, however, and this initial assessment could change if crypto-assets were to become significantly more widely used or interconnected with the core of the regulated financial system. For example, wider use and greater interconnectedness could, if it occurred without material improvements in conduct, market integrity and cyber resilience, pose financial stability risks through confidence effects. To support monitoring and timely identification of emerging financial stability risks, the FSB will identify metrics and any data gaps.

Crypto-assets raise a host of issues around consumer and investor protection, as well as their use to shield illicit activity and for money laundering and terrorist financing. At the same time, the technologies underlying them have the potential to improve the efficiency and inclusiveness of both the financial system and the economy.

Relevant national authorities have begun to address these issues. Given the global nature of these markets, further international coordination is warranted, supported by international organisations such as CPMI, FATF and IOSCO.

- The FSB will identify metrics for enhanced monitoring of the financial stability risks posed by crypto-assets and update the G20 as appropriate.

2. DISCIPLINED COMPLETION OF THE G20'S OUTSTANDING FINANCIAL REFORM PRIORITIES

The FSB is making significant progress on the G20's outstanding financial reform priorities, with a large number of initiatives on track to be completed by or before the Buenos Aires Summit.

The recent agreement on a package finalising the *Basel III banking reforms* marks completion of one of the most significant areas of post-crisis policy design. Emphasis will now be on full, timely and consistent implementation in order to secure the benefits of a resilient international banking system, equipped with the regulatory certainty to lend and invest across borders. Attention can now be dedicated to the small number of remaining areas where G20 financial reform priorities need to be completed.

De-risking in *correspondent banking* relationships has threatened the ability of some emerging market and developing economies to access the international financial system, with consequences for financial inclusion, and it risks driving flows underground. The FSB is on track to deliver on all elements of its correspondent banking Action Plan by the Buenos Aires Summit, specifically regular production of data on trends; clarification of regulatory expectations; supporting domestic capacity-building through technical assistance; and stronger tools for due diligence by banks. The FSB welcomes the Wolfsberg Group initiative, which represents a powerful and timely private sector solution to help clarify what major international banks expect respondent banks to demonstrate in order to more safely and reliably access international banking services.

The G20 has also tasked the FSB with identifying the barriers that remittance providers face in accessing banking services. This was motivated by specific concerns about impacts of de-risking on the remittance sector and the consequences for developing countries, where remittance flows are a key source of funds. In response, the FSB has identified four strategic recommendations for national authorities in the areas of consistency of regulatory frameworks, effectiveness of supervision, application of technology, and technical assistance.

By the Buenos Aires Summit the FSB will deliver a final report on policy development under its Action Plan. After this, relevant standard-setting and international bodies, under the coordination of the FSB, will pick up the mantle of monitoring implementation of the Action Plan by national authorities.

- For this March G20 meeting, the FSB has delivered a progress report on the correspondent banking Action Plan. A final report will be issued by the Buenos Aires Summit.

- For this March G20 meeting, the FSB has delivered four strategic recommendations for improving the access of remittance providers to banking services. The FSB will deliver a report on the implementation of these recommendations to the G20 Finance Ministers and Central Bank Governors in July 2019.

The FSB's coordinated workplan to reduce *misconduct* in the financial sector has made important strides over the past year in promoting incentives for good behaviour through a variety of tools including: standards and codes, such as the Global FX Code; IOSCO's toolkit of measures on wholesale market conduct; and the FSB's principles for sound compensation practices. The FSB will shortly complete the final element of its work when it publishes a toolkit for firms and supervisors on the use of governance frameworks to mitigate misconduct risk. This report

addresses three areas: i) dealing with those individuals with a history of misconduct who move between firms (so-called 'rolling bad apples'); ii) strengthening senior-level accountability by being clear about responsibilities within firms; and iii) examining the role of corporate culture in misconduct. In addition, guidance on the use of compensation tools to promote good conduct has now been published in final form and is to be followed up by recommendations on national data collection on compensation and conduct. G20 national authorities can now consider how they can best draw on this work to strengthen and maintain conduct in their own financial sectors.

- The FSB will publish later this month a toolkit for firms and supervisors on how governance frameworks can be used to address misconduct risk.

Market-based finance provides new sources of funding and investment, promotes international capital flows, reduces reliance on bank funding and brings welcome diversity to the financial system. The FSB's latest annual monitoring report shows sustained growth in non-bank financial activity (with the activity-based, narrow measure of shadow banking growing by 7.6% in 2016 to $45 trillion for the 29 jurisdictions covered, including for the first time China and Luxembourg). It is vital that resilience of non-bank finance is promoted and maintained as it evolves. To this end, the FSB's 2017 recommendations to address structural vulnerabilities from asset management activities will be made operational by IOSCO this year. In February, IOSCO issued final recommendations to improve liquidity risk management practices in open-ended funds. In addition, IOSCO is developing consistent measures of leverage within funds. Once implementation is progressed, IOSCO and FSB will assess if these recommendations have been implemented effectively, and the FSB will report back to the G20.

- By the July 2018 G20 meeting of Finance Ministers and Central Bank Governors, IOSCO will issue a consultation report with proposals for developing comparable leverage measures for funds, as part of the operationalisation of the FSB's recommendations on structural vulnerabilities from asset management activities.

The extent to which the central clearing of OTC derivatives transactions supports the G20's efforts to reduce systemic risk depends on the resilience and resolvability of *central counterparties* (CCPs). The FSB is following up on its 2017 Guidance on Central Counterparty Resolution and Resolution Planning with an assessment, based on further analysis and experience gained in resolution planning, of whether there is a need for additional guidance on the financial resources available to support CCP resolution and the treatment of CCP equity in resolution.

- By the Buenos Aires Summit, the FSB will determine whether there is need for any additional guidance on the treatment of CCP equity in resolution and financial resources to support CCP resolution.

To respond to the risks posed to the financial sector from *cyber incidents*, the FSB is building on the 2017 stocktake of members' existing practices on cyber security, by developing a common lexicon to support consistency in the work of the FSB, standard-setting bodies, authorities and private sector participants. The FSB has also undertaken further analysis to improve

understanding of the transmission channels through which a cyber incident could affect the financial system.

- By the Buenos Aires Summit, the FSB will deliver a common international lexicon of cyber security terms, to support the work of the FSB, standard-setting bodies, authorities and the financial sector.

To mitigate *climate-related financial risks*, the private-sector-led Task Force on Climate-related Financial Disclosures (TCFD) is now focused on promoting companies' voluntary implementation of its recommendations, which were issued for the Hamburg Summit. Companies from a broad range of sectors are beginning to make TCFD disclosures. The financial sector will play an important role in fostering wider adoption and raising standards, so it is notable that financial institutions responsible for over $80 trillion of assets have signalled their support, including 20 globally-systemic banks, eight of the top 10 asset managers, the world's leading pension funds and insurers, major ratings agencies and accounting firms, and the two dominant shareholder advisory services companies.

- By the Buenos Aires Summit, the TCFD will report on voluntary implementation, focusing on areas of good practice to foster wider adoption.

3. PIVOTING TO POLICY EVALUATION TO ENSURE THE REFORM PROGRAMME IS EFFICIENT, COHERENT AND EFFECTIVE

As its work to fix the fault lines that caused the financial crisis draws to a close, the FSB is increasingly pivoting away from design of new policy initiatives towards dynamic implementation and 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 either the original objectives of the reforms or the agreed level of resilience. This *dynamic implementation* of the G20 reforms will ensure that reforms remain fit for purpose amidst changing circumstances. The new policy evaluation framework delivered to the 2017 G20 Summit is being applied for the first time during the Argentine Presidency, with the FSB reporting on two evaluations and setting priorities for future evaluation topics.

The first evaluation, on financial intermediation, supports the Argentine G20 Presidency's focus on *infrastructure investment*. The aim in 2018 is to assess how financial reforms affect the availability and cost of infrastructure finance, and whether, whilst strengthening the financial system, reforms have had unintended consequences on financial intermediation. The FSB will deliver the evaluation on infrastructure to the Argentine G20 Summit. In May 2018 work will also begin evaluating the effects of financial regulation on financing for SMEs, with a view to delivering that assessment under the Japanese G20 Presidency.

- By the Buenos Aires Summit, the FSB will deliver its report on the effects of financial reforms on the financing of infrastructure investment.

- By the 2019 Leaders' Summit, the FSB will deliver to the Japanese Presidency a report evaluating effects, including any unintended consequences, of financial regulation on access to finance for SMEs.

The second evaluation concerns the effects of the overall set of post-crisis reforms on *incentives for market participants to centrally clear OTC derivatives*. The FSB's 2017 review of the effectiveness and broader effects of the G20's reforms of OTC derivative markets found that meaningful progress has been made toward meeting the G20 objectives – particularly mitigating systemic risk – and that implementation was well progressed. However, the review also noted some concerns about the interactions of the broader set of post-crisis reforms on incentives for central clearing, and questions about whether there are unintended consequences, in particular relating to the costs and availability of clearing for end-users. The second evaluation is being undertaken together with the SSBs as well as in coordination with a BCBS review of the effects of the leverage ratio on client clearing. The results of these reviews will inform any possible decisions about whether and how to adjust the relevant post-crisis regulations.

- By the Buenos Aires Summit, the FSB will deliver the report evaluating the effects of reforms on incentives to centrally clear OTC derivatives.

To support the FSB's increased focus on evaluation work over coming years, we are developing a forward schedule of additional evaluations, based on proposals from FSB members. This already includes a plan to evaluate the effects of the reforms aimed at ending "too-big-to-fail" by 2020. The FSB is also developing a new framework for collecting data from financial firms to support policy evaluation, which will enhance the FSB's ability to conduct incisive and rigorous analysis while upholding high standards of data protection and governance.

4. OPTIMISING HOW THE FSB WORKS IN ORDER TO MAXIMISE ITS EFFECTIVENESS

The FSB has developed the international reforms necessary to fix the fault lines that caused the financial crisis through a collaborative, consensus-based approach that relies on the expertise of its members in order to deliver efficient and decisive analysis and action. The success of the FSB is a testimony to the skill and determination of its members and the quality of their contributions, supported by a small secretariat of around 30 people, many of whom are on posting from member authorities. This model allows the FSB to be in constant touch with member priorities, to respond nimbly to changing circumstances and emerging risks, to focus resources on the issues that matter most, and to convene those with the authority to take action.

To make sure it is fit for the next phase, the FSB's membership is undertaking a thorough review of how the FSB works. The pivot from policy development to implementation and evaluation is already happening with, over the course of 2017, the number of FSB working groups having fallen by 25% as those that have completed their policy work are disbanded. To seek ways to further improve the way the FSB works, the review will consider FSB transparency, consultation, mechanisms for setting our strategic agenda, and how to ensure discipline and efficiency in our

member-led groups charged with analysis and policy development, implementation and evaluation.

In this way the FSB will continue to promote strong, shared international standards; dynamic implementation; and cooperation in financial regulation and supervision – all of which are essential building blocks to maintain a resilient, open international financial system, which supports the G20 objective of strong, sustainable and balanced growth.

Yours sincerely

Mark Carney

Annex A: Priority G20 deliverables from the FSB during the Argentine G20 Presidency

Deliverable	Topic	Timing
BCBS finalisation of Basel III	Building resilient financial institutions	Completed in December 2017
Correspondent banking progress reports	Correspondent banking	March 2018 and Summit
FSB report and recommendations on remittance firms' access to banking services	Correspondent banking	March 2018
FSB toolkit on governance measures to address misconduct	Misconduct risk	Publication in March 2018, and delivery to April 2018 meeting
FSB evaluation of incentives to centrally clear OTC derivatives	Implementation and evaluation of reforms	Summit (with emerging findings in July)
FSB evaluation on the effects of financial reforms on the financing of infrastructure investment	Implementation and evaluation of reforms	Summit (with emerging findings in July)
IOSCO consultative report on consistent measures of leverage in funds	Transforming shadow banking into resilient market-based finance	July 2018
FSB assessment of the need for further guidance on the treatment of CCP equity in resolution and on the adequacy of CCP financial resources in resolution	Ending too-big-to-fail	Summit
FSB financial sector cyber security lexicon	Financial technology and cyber risk	Summit
Report on implementation of recommendations of the Task Force on Climate-related Financial Disclosures	Climate-related financial risk disclosures	Summit
FSB fourth annual report on implementation and effects of reforms	All post-crisis reform areas	Summit
FSB Chair's letter to G20 Leaders	Priorities and deliverables	Summit