FSB FINANCIAL STABILITY BOARD

As prepared for delivery

Three priorities for international regulatory and supervisory cooperation

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Ladies and Gentlemen,

Looking back over the past decade, the G20 reforms coordinated by the FSB have made the core of the financial system safer and simpler. Global systemically important banks now hold €1.2 trillion more capital than in 2011.[2] OTC derivatives markets are more transparent and better collateralised. Almost three quarters of USD and EUR interest rate contracts are now being cleared via central counterparties.[3] Importantly, greater resilience has been achieved without negatively impacting the overall supply of credit to the real economy, defying concerns raised when the reforms were announced.

The FSB is pivoting from post-crisis policy design to reinforcing the resilience of the global financial system. This pivot reflects evolving priorities for international regulatory and supervisory cooperation. Today, I would like to discuss three such priorities that could be summarised as the three "I-s": implementation, integration and innovation.

Implementation

The full, timely and consistent implementation of the agreed reforms is a precondition for achieving the intended levels of financial resilience. It is too early to declare the job done. The FSB's annual report[4] to G20 Leaders shows that implementation progress remains uneven, both across reform areas and across jurisdictions. Remaining work includes: implementing the final Basel III reforms; operationalising resolution plans for cross-border banks and building effective resolution regimes for insurers and central counterparties; making OTC derivatives trade reporting more effective; and further strengthening the oversight and regulation of non-bank financial intermediation.

Ensuring resilience in all these areas is important as vulnerabilities persist and in some cases have increased further. Elevated asset values, high private and public debt, and deteriorating credit quality all pose risks. Since 2010, the share of corporate issuers with the lowest investment grade rating has risen from around 14% to 45% in Europe and from 29% to 36% in the United States.[5] There are questions about the extent of financial institutions' exposures to riskier credits, including leveraged loans, but also through collateralised loan obligations

[1] The views expressed in this speech are those of the speaker and do not necessarily reflect those of the FSB or its members.
[2] Basel Committee on Banking Supervision, *Basel III Monitoring Report*, March 2019
[3] Bank for International Settlements, *OTC derivatives statistics at end-December 2018*, May 2019
[4] Financial Stability Board, *Progress in implementation of G20 financial regulatory reforms*, June 2019
[5] Bank for International Settlements, *Quarterly Review*, March 2019

(CLOs). While CLO structures appear more robust now than pre-crisis, leveraged loan credit quality has deteriorated over the past few years and it remains unclear whether CLO prices are aligned with risk.

Limited fiscal and monetary policy space increases the risk that authorities have fewer tools that 10 years ago to deal with shocks to the financial system. And an end to the period of very low interest rates and search for yield seems out of sight. This heightens the importance of effective supervision that includes a macroprudential perspective. Given this backdrop, it is important that quick, analytically robust, assessments of risks can be shared by authorities and where necessary acted on. The FSB is currently reviewing its surveillance framework to ensure that it can provide such assessments.

Integration

A second priority is to preserve the benefits of integrated financial markets, including in terms of financial stability. G20 Leaders recognised the economic benefits of an open, integrated financial system early on, and the post-crisis reforms were designed to foster integration. Promoting integration is an ongoing task as markets evolve and regulatory reform is moving on to implementation and evaluation. It is against this backdrop that the FSB embarked on work on market fragmentation, and published a report on the topic in June.[6]

The relationship between market fragmentation and financial regulation is complex. Some types of market fragmentation can be seen as a by-product of measures to improve domestic resilience. In places, such fragmentation can have a positive effect on financial stability, for instance by reducing the transmission of economic shocks between jurisdictions. But there may be instances of 'unintended' fragmentation, potentially with adverse consequences for financial stability, through limiting opportunities for cross-border diversification and risk management, impairing market liquidity or preventing capital and liquidity from being channelled to where it is needed in periods of stress.

The challenge is to identify and address harmful fragmentation. Recognising this challenge, the FSB report lays out approaches and mechanisms that may enhance the effectiveness and efficiency of international cooperation, and help to mitigate any negative effects of market fragmentation on financial stability. This includes steps to consider issues around market fragmentation at different stages: as policies are developed; as they are implemented; and when they are being evaluated.

That the G20 Leaders welcomed the FSB's work on market fragmentation and committed to address unintended, negative effects is a strong signal about the importance of preserving integrated markets, and the important role that international cooperation plays in this regard. Indeed, work is being taken forward on deference processes in derivatives markets; pre-positioning of capital and liquidity by international banks; and as part of the FSB's evaluation of too-big-to-fail reforms.

[6] FSB, *FSB Report on Market Fragmentation*, June 2019

Innovation

The third priority concerns financial innovation. Technological innovation holds great promise for the provision of financial services, with the potential to increase market access and the range of product offerings, and lower costs to clients. Authorities need to find ways to harness the benefits of digital innovation while containing risks. This is obviously a challenge that regulation always faces. But digital innovation is special because of its pervasiveness, and potential disruptiveness. The impact of digitalisation ranges from the plumbing of regulation and supervision – regtech and suptech are the buzzwords here – to broad strategic questions concerning the approach of regulation. Let me highlight two examples.

New technologies such as distributed ledger technology could lead to a more decentralised financial system – by eliminating, or reducing the role, of intermediaries that have traditionally been involved in the provision of financial services. Decentralisation may pose challenges for financial regulatory and supervisory frameworks focused on centralised financial institutions, including question around the location of financial assets or records. More fundamentally, a more decentralised financial system may reinforce the importance of an activity-based approach to regulation, particularly where it delivers financial services that are difficult to link to specific entities and/or jurisdictions.[7]

New entrants into the financial services space, including FinTech firms and large, established technology companies ('BigTech'), could materially alter the universe of financial services providers. This could in turn affect the degree of concentration and contestability in financial services, with both potential benefits and risks for financial stability. A recent example are proposals to use new types of crypto-assets for retail payment purposes on a broad, potentially global scale. In the Osaka Summit Declaration,[8] G20 Leaders have called on the FSB to assess the implications of such new developments and advise on multilateral response as appropriate.

International cooperation

Let me conclude with a fourth I – international cooperation. The priorities I have discussed reinforce the case for international cooperation – because of the intrinsically global nature of key financial markets and technological innovation, and because of the potential global impact of financial instability.

For the FSB, this means completing the pivot in our work priorities that I mentioned at the beginning. It also means working with all stakeholders to understand the challenges that lie ahead, and find solutions that support sustained economic growth and financial stability.

Thank you for your attention.

[7] Financial Stability Board, *Decentralised financial technologies: Report on financial stability, regulatory and governance implications*, June 2019

[8] G20, *G20 Osaka Leaders' Declaration*, June 2019