FSB FINANCIAL STABILITY BOARD

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

Report of the Financial Stability Board to G20 Leaders

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1. Introduction

The G20 committed in 2008 to a fundamental reform of the financial system, to correct the fault lines that led to the global financial crisis and to rebuild the financial system as a safer, more resilient source of finance that better serves the real economy. To achieve this, the G20 called on the FSB to coordinate the development of a robust and comprehensive framework for global regulation and oversight of what is now a global financial system.

Fundamental reform of financial regulation was clearly necessary. The financial boom before the crisis was fuelled by excessive and mismanaged debt. Many banks were significantly undercapitalised relative to the risks they ran. Regulators and supervisors did not adequately appreciate and address the risks building up in the financial system. When the crisis hit, many markets seized up, transmitting its effects across the globe. The loss of confidence in financial markets and institutions was only halted through authorities backstopping the system. Several institutions that were "too big to fail" passed their losses to taxpayers, while leaving a legacy of economic weakness. Despite these measures, the crisis triggered a global recession and enormous costs to government balance sheets, to economies and to citizens. Its legacy continues to pose financial stability risks to the system and is delaying economic recovery.

Over the past five years, FSB members **have agreed and are implementing a broad range of policy reforms that address the major fault lines that caused the crisis.** We are building more resilient financial institutions and markets, using substantially strengthened common international standards that have been designed to be applicable to different national circumstances. We are addressing the problem of too-big-to-fail. At the same time, we are working to prevent regulatory arbitrage - through which tightening regulation in one sector or region is simply followed by the migration of risky activity elsewhere - and have committed to ensure that all financial markets, products and participants are regulated or subject to oversight, as appropriate to their circumstances. We are building a framework for robust market-based finance that will promote continuously functioning markets.

By reducing the risk of future financial crises and the consequences of financial instability for the real economy, these reforms are an essential contribution to the G20's primary objective of strong, sustainable and balanced growth.

Our work has advanced substantially, but it is not yet complete. It is crucial that we stay the course and complete the reforms, implementing them in a rigorous, coordinated and consistent manner in order to address fully the problems that led to the crisis. To ensure that they endure, the reforms must be complemented by constant monitoring of potential vulnerabilities in our financial systems and heightened readiness to address any new fault lines that might appear. And we must continue to build the institutions and co-operative cross-border mechanisms to realise fully the benefits of an open, integrated and global financial system that supports strong, sustainable and balanced growth, including job creation.

1.1 Correcting the fault lines that caused the crisis

We are building more resilient financial institutions

In 2010 the G20 endorsed Basel III as a fundamental overhaul of international regulatory standards for banks, to substantially raise the quantity and quality of their capital and liquidity. Almost all FSB and G20 jurisdictions have now adopted rules to implement those new standards according to a timeline that avoids economic disruption. And they are rigorously reviewing each other's practical implementation of the standards line-by-line.

Following the crisis the capital of many banks, including globally significant ones, was severely depleted. But many are now on course to meet the new minimum requirements well ahead of the 2019 deadline for full implementation. The shortfall in equity capital today from the 2019 minimum is only half a year's profits for the largest banks. Where banks have successfully built capital, access to credit has returned, supporting economic recovery.

But there are still major challenges. The strengthening in capital has been uneven, and some banks still need significant repair of their balance sheets. Moreover, analysis of the risk models that banks use to calculate their capital needs shows large differences that cannot be explained by underlying risks, and that are driven instead by supervisory decisions and differences in bank risk models. This highlights the importance of improving the comparability across banks of the risk weights used, and having a simple leverage ratio requirement as a backstop to risk-based measures. We need to address these remaining issues if we are to rebuild fully confidence in the strength of bank balance sheets.

Some final pieces of the new international framework will be finalised very shortly: for example, the leverage ratio by early 2014. In light of the progress made, a strategic review is taking place of whether the current capital framework achieves the right balance between simplicity, risk sensitivity, and comparability across banks.

We have also made progress in correcting the compensation structures at financial institutions which created the perverse incentives for employees to focus only on short-term profits without regard to the longer-term risks they imposed on their firms.

We are increasing transparency

For markets to make their own credit and risk assessments and for authorities to oversee participants, they need good data and good processes. The FSB has been coordinating several initiatives to improve the quality of information available to the market and to authorities.

Some of these aim at improving the information available about individual financial institutions:

- Improving the risk disclosures made by banks to investors and counterparties, for example through practical recommendations made last year by a private sector Enhanced Disclosure Task Force, in which the FSB brought together banks, investors and other stakeholders;
- Addressing data gaps, including in the data shared among authorities on the risk exposures and funding of global systemically important banks.

- Strengthening accounting standards, and making financial accounts more internationally comparable, by encouraging the International Accounting Standards Board and the US Financial Accounting Standards Board to agree on high-quality converged standards;

Other initiatives will improve the information available about financial markets:

- Establishing a global legal entity identifier, for uniquely identifying counterparties to financial transactions.
- Establishing a global monitoring framework for shadow banking.
- Ensuring that all transactions in the previously lightly regulated over-the-counter derivatives market are reported to trade repositories and that all standardised contracts be traded on exchanges or electronic platforms, where appropriate.
- Reforming the processes for setting financial benchmarks, so that earlier market abuses such as occurred with LIBOR and other benchmarks are not repeated.

Initiatives such as these will enable authorities and markets to better understand the risks faced not only by individual firms but also the system as a whole, and that better understanding will itself make the system more stable. Further efforts are needed to complete some of these initiatives. We are in particular further encouraging the accounting standard-setters to complete the convergence of standards in two key areas - loan loss provisioning and insurance.

We have made substantial progress towards ending too-big-to-fail

Following the collapse of Lehman Brothers and the subsequent public rescue of many large banks, G20 Leaders called on the FSB to propose measures to address the problems associated with systemically important financial institutions (SIFIs). The "too-big-to-fail" problem arises when a SIFI's threatened failure forces public authorities to bail it out to avoid large-scale financial instability and long-lasting economic damage. The resulting public absorption of private losses distorts incentives, leading to excessive risk-taking by SIFIs, and can be ruinous for public finances.

Substantial progress has been made in developing and implementing policies to end too-big-to-fail, as detailed in a separate report for this Summit. We are identifying SIFIs in different sectors, and applying three types of measures to sharply reduce the threat that their failure poses to the wider system:

- changes to legal and operational regimes to enable all financial institutions, including those operating across borders, to be resolved safely and without taxpayer loss if they fail;
- requirements that SIFIs have higher loss absorbency to provide greater protection, given the greater economic impact of their failure compared with institutions that are smaller and less central to the system;
- more intensive and effective supervisory oversight (including sharing of risk data) to reflect the additional complexity of these institutions and the systemic risks they pose

Firms and markets are beginning to adjust to authorities' determination to end too-big-to-fail, with signs of reduced expectations of taxpayer support both in credit rating agency ratings given to SIFIs and in the market prices of their credit. However, legislative reforms to implement the Key Attributes of Effective Resolution Regimes are necessary in many countries if the SIFI framework is to be fully credible and lead to changes in firms' and markets' behaviour. Several jurisdictions have made reforms, but further actions are needed to give authorities additional resolution powers and tools We therefore urge that all G20 countries change legislation as needed to meet the Key Attributes by end-2015.

Banks must also be structured so that they are resolvable in a crisis. To that end, we are requesting your endorsement of further measures to make cross-border institutions resolvable, as detailed in the separate report on progress in ending too-big-to-fail. In particular, to strengthen confidence about the effectiveness of cross-border resolution strategies, an international approach is needed on the adequacy of loss absorption capacity in resolution, including on the nature, amount and location within the financial group's structure.

Structural reform measures at a national level can also help to address the too-big-to-fail problem by restraining excessive risk-taking and improving the resolvability of SIFIs**.** At the same time, there is a risk that diverging structural measures in different countries could impede the integration of international markets. FSB members will therefore monitor and discuss the potential cross-border spill-over effects.

Strengthened supervision of the largest financial institutions is a key element of the SIFI policy framework, but has not progressed apace with other measures. To improve supervisory effectiveness, authorities must ensure that supervisory agencies are adequately resourced (including in skills and experience), have clear mandates and have the independence and accountability they need to deliver high quality supervision.

We are filling regulatory gaps

Authorities must manage systemic risk effectively wherever it arises. And we must avoid leaving regulatory gaps, which could mean that, when regulations are tightened in one area, market participants simply move risky activities to less regulated sectors.

The reform programme is aimed at ensuring comprehensive regulation and oversight of the system. Policy measures should be appropriate to the systemic risks posed, whichever type of institution or market in which they arise. For this reason, the framework to end too-big-to-fail described above covers all types of financial institutions that are identified as being systemically important. Another example of our work to fill regulatory gaps is our initiative to strengthen oversight and regulation of shadow banking.

We are addressing the systemic risks from shadow banking

Non-bank financial intermediation provides a valuable alternative to banks in providing credit in support of economic activity. The crisis however revealed systemic risks from important fault lines in the shadow banking system that had lain mostly unrecognised during its rapid expansion. Key amongst these were a heavy reliance on short-term wholesale funding, a variety of incentives problems in securitisation that weakened lending standards, and a general lack of transparency that hid growing amounts of leverage, maturity and liquidity

transformation. When risks manifested, these factors caused credit intermediation through the shadow banking system to come to a dramatic halt.

At the Cannes Summit in 2011, G20 leaders agreed to strengthen the regulation and oversight of the shadow banking system. We have developed a set of policies to address the systemic risks that shadow banking can pose. They focus on the types of shadow banking that led to concerns during the crisis, but also set out an overall policy framework for authorities to identify and address shadow banking risks wherever they may arise in future. Our aim is for shadow banking to deliver transparent and resilient market-based financing, thus diversifying the sources of financing of our economies in a sustainable way.

1.2 Promoting continuously-functioning financial markets

A move to market-based finance emphasises the importance of having continuously-functioning markets. The crisis highlighted how the interconnectedness of the major firms and markets in the financial system can lead to rapid contagion when markets and liquidity suddenly dry up. The G20 and the FSB are implementing several policy initiatives to reduce the systemic risks arising from the exposures of the largest financial institutions to each other and to create more continuously functioning markets. The goal is to ensure that markets remain liquid and their participants well protected against default by one of their number, so that markets can be sources of strength rather than weakness, even at times of stress.

We are making the derivatives markets safer

The global financial crisis of 2008 highlighted structural deficiencies in the lightly regulated over-the-counter derivatives market, and the systemic risk it posed for the wider market and economy. Regulators did not have sufficient information on derivatives positions held by market participants to be able to assess the build-up of risky exposures.

The over-the-counter derivatives market is now being comprehensively reformed. We are increasing transparency through requirements to trade on organised platforms and report transactions to trade repositories. We are also reducing and more systematically controlling the exposures financial firms have to each other in this market, by ensuring that central counterparties are placed between the two participants in standardised transactions, by setting minimum capital and margining requirements.

In this global market, it is essential that consistent rules apply across jurisdictions in a non-discriminatory way. We are reporting separately on the understandings among regulators on how they will regulate the cross-border market. Regulators should continue to cooperate in the application of regulations in cross-border contexts, to enable them to defer to each other's rules where these achieve similar outcomes.

We are strengthening market infrastructure

Authorities are requiring greater use of market infrastructure, such as central counterparties, in order to reduce the interconnectedness between firms that can lead to contagion in a crisis. Robust financial market infrastructures make an essential contribution to financial stability by reducing what could otherwise be a major source of systemic risk. At the same time, authorities must take steps to ensure that a core financial infrastructure does not itself become

a source of systemic risk. New and more demanding international principles have been developed for the safety and soundness of all systemically important financial market infrastructures, including central counterparties, payment systems, central securities depositories, securities settlement systems and trade repositories. We have provided guidance on the application of the Key Attributes of Effective Resolution Regimes to infrastructures. This is being supported by a formal process to monitor consistent national implementation of the principles.

We are reforming credit rating agencies and reducing reliance on them

Other steps are being taken to make markets less prone to boom-bust cycles and to reduce herd behaviour. Credit rating agencies are now subject to stronger oversight, regulation and transparency requirements about their underlying processes, following the agencies' conflicts of interest and the failures in rating practices for structured products that contributed to the crisis. However, authorities and standard-setting bodies need to accelerate work to end market participants' mechanistic reliance on external ratings, which can lead to herd behaviour and cliff effects in market prices when downgrades occur. Firms must take responsibility for their investments by performing their own credit assessment and due diligence instead. Authorities in most G20 countries have made only slow progress to reduce reliance across the different financial sectors, and they have agreed to develop action plans to accelerate efforts.

1.3 Realising fully the benefits of an open, integrated and resilient global financial system

Strengthening confidence in an open, global financial system

Short-term incentives to protect domestic economies and taxpayers can sometimes appear to outweigh the longer-term benefits of a global system. The depth of the crisis and the accompanying dislocation of cross-border activities reinforce that bias. Fragmentation of the international financial system could reduce growth by putting up barriers to the efficient allocation of capital and liquidity in the real economy. Reforms that strengthen confidence in the resilience of national and global financial systems, including the prospects for economic growth, and that prevent regulatory arbitrage, will reduce the risk of contagion between jurisdictions in our integrated global financial system and help to mitigate incentives to protect and ring-fence national systems. It is vital therefore that we continue to demonstrate our common commitment to complete the financial reforms. To this end, the FSB coordinates regular public reporting by authorities of progress in developing and implementing global policy reforms, including through this progress report to the Summit.

Ensuring timely, consistent implementation of new regulatory standards

The package of reforms can only be effective in truly addressing risks and rebuilding confidence if it is fully and consistently implemented, and seen to be so. For this reason, the FSB is coordinating with the standard setting bodies a rigorous monitoring and peer review process that assesses and publicly reports on whether countries are fully and effectively implementing reforms, with a particularly intense monitoring of six priority areas for reform - the Basel capital and liquidity framework; derivatives market reforms; compensation practices; policy measures for global SIFIs; resolution frameworks; and shadow banking. We

are also monitoring the effects of reforms on the real economy and on the financial system's ability to play its role as a source of financing for long-term investment. Where unintended consequences or improved methods of achieving the desired outcome are identified, the regulatory community is prepared to respond.

Deferring to each other's rules where these deliver similar outcomes

Financial markets and many of the largest financial institutions are global, but – notwithstanding agreements on international standards – financial regulation remains ultimately national or regional. To prevent regulatory arbitrage, regulation needs to cover comprehensively global financial markets and institutions, while avoiding conflicts, inconsistencies and unnecessary duplication between regimes. This does not necessarily mean that different jurisdictions need to have identical regulations, as long as they have similar outcomes.

Recent progress in regulatory cross-border cooperation on OTC derivatives provides an example of the type of approach needed. In July 2013 G20 Finance Ministers and Governors agreed that jurisdictions and regulators should be able to defer to each other when it is justified by the quality of their respective regulations and enforcement regimes, based on essentially identical outcomes, in a non-discriminatory way, paying due respect to home country regulations.

More generally across the reform agenda, the FSB promotes outcomes-based approaches to assessing the consistency of implementation of agreed reforms, enabling jurisdictions to defer to each other's rules where they deliver similar outcomes, thus avoiding one-size-fits-all solutions.

Enhancing cooperation and information sharing

Proper oversight of cross-border financial institutions and markets requires cooperation between financial authorities.

We need to enhance the operations of colleges through which supervisory cooperation takes place, through sharing of good practices, and strengthen channels for supervisors to share data and other information. The FSB will develop recommendations by end-2014 for strengthening supervisory colleges.

The home and key host authorities for each global SIFI have set up a cross-border crisis management group so as to cooperate in the preparation for, and management of, a crisis in such firms. We must improve cooperation within these groups. We will also develop recommendations by early 2014 on cooperation and information sharing with authorities where a global SIFI is systemic in their jurisdiction but they are not on the crisis management group.

The G20 should continue to encourage adherence to the international standards for effective cooperation and information exchange between financial sector supervisors and regulators in different countries. All G20 countries should lead by example through their own implementation of the standards and demonstrate their readiness to handle the case of non-cooperative jurisdictions.

Continuing to cooperate

Mechanisms such as the G20 and FSB enable the cooperation in policy development, oversight and crisis management that a global financial system requires. At the G20's request, the FSB has been placed on a firmer international footing by becoming a separate legal entity in early 2013, while continuing to be hosted and funded by the Bank for International Settlements.

We are also reaching out to a broader community through a variety of fora – including Regional Consultative Groups that bring an additional 70 countries into the policy discussion, workshops involving a wide range of stakeholders and public consultations on policy proposals.

1.4 Conclusion: Towards a financial system that supports strong, sustainable and balanced economic growth

G20 support to complete the set of international reforms and implement them in a full, timely and consistent way will not only build more resilient national systems but also, by building confidence in each other's commitments, support a more effective and open system. The result will be a resilient global financial system that serves an increasingly global real economy throughout the economic cycle, despite inevitable economic shocks. That system will best support the G20's ultimate objective of strong, sustainable and balanced economic growth and will help create jobs.

2. Building resilient financial institutions

2.1 Implementation of Basel II/II.5/III

Full, timely, and consistent implementation of Basel II/2.5/III remains fundamental to building a resilient financial system that can support strong and sustainable growth, fostering public confidence in regulatory ratios, and providing a level playing field for internationally active banks. In November 2011, G20 Leaders at the Cannes Summit called on jurisdictions to meet their commitment to implement fully and consistently Basel II and Basel 2.5 by end 2011, and Basel III starting in 2013 and completing full implementation by 1 January 2019. In June 2012, G20 Leaders at the Los Cabos Summit reaffirmed their call for jurisdictions to meet their commitments.

To monitor progress and assess the implementation of Basel III, the Basel Committee on Banking Supervision (BCBS) has put in place the Regulatory Consistency Assessment Programme (RCAP). The RCAP consists of two parts: (i) *monitoring*, which includes the timely adoption of new Basel standards by member jurisdictions and of banks' progress in raising capital and liquidity buffers to meet the new minimum requirements; and (ii) *assessments and review studies*, which includes the assessments of local capital, liquidity, leverage and systemically important bank (SIB) regulations and their consistency with the Basel standards, and analytical reviews of banks' calculations of capital ratios, risk-weighted assets (RWAs), and other regulatory outcomes. The RCAP is also helping emphasise that effective functioning of the Basel III framework depends both on a sound regulatory framework as well as effective supervisory and industry practices.

Member jurisdictions have made considerable progress since the June 2012 G20 Summit. In terms of capital requirements, 24 out of the 27 BCBS member jurisdictions have now fully implemented Basel II;[1] 22 have fully implemented Basel 2.5;[2] and 25 have now issued the final set of Basel III based capital regulations.[3] Most recently, the European Union (EU) and the United States (US) issued final Basel III regulations in June and July 2013 respectively. This is an important development as all designated global systemically important banks (G-SIBs) are headquartered in jurisdictions that have now adopted the Basel III framework and are in the process of implementing it.

Regarding the adoption of regulations relating to the Liquidity Coverage Ratio (LCR), 11 BCBS member jurisdictions have issued final rules (South Africa, Switzerland and EU member states), while four jurisdictions have started the implementation process by issuing consultation documents or draft rules (Australia, Hong Kong SAR, India, Turkey). The agreed start date for the phase-in of liquidity requirements is 1 January 2015.

As part of the RCAP, the BCBS has started to assess in detail the consistency of local regulations implementing the Basel III standards. It aims to complete a first assessment of Basel III capital regulations for all BCBS member jurisdictions by the end of 2015. Since 2012, the BCBS has assessed the consistency of final risk-based capital regulations in Japan, Singapore and Switzerland as well as draft capital regulations in the EU and the United States.[4] The Committee is currently in the process of assessing China, Brazil and Australia, while new assessments of the EU and United States, as well as the assessment of Canada, will be completed in 2014. The assessments of Mexico, Hong Kong SAR and South Africa will be initiated during 2014.

The RCAP assessments cover not only the substance of the local regulations but also their form, i.e. whether the rules are laid down in regulatory instruments that are binding from a regulatory and supervisory perspective. The assessments are demonstrably contributing to greater consistency in the national adoption of Basel III risk-based capital standards. For example, in the case of Japan, Singapore and Switzerland, the domestic regulatory authorities promptly resolved a number of initial assessment findings by amending the domestic regulations that implement Basel III capital standards.

Also as part of the RCAP, the BCBS has initiated analytical studies to examine the consistency of RWA measurement by banks that use internal model approaches. Following the first report on the measurement of market RWAs issued in January 2013,[5] the Committee published a second report on the regulatory consistency of RWAs for credit risk in the

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[1] The United States has issued final regulations on Basel II; however, its largest banks are still on parallel run for implementing the advanced approaches. Argentina and Russia have also initiated the process to complete the implementation of Basel II.

[2] Of the other five members, the United States has issued the remaining part of the rules which will come into force in 2014; Argentina, Indonesia, Mexico and Russia have either partially adopted Basel 2.5 or have initiated steps to do so.

[3] Indonesia and Turkey have draft rules in place and efforts are underway to finalise them. Final Basel III capital rules are already legally in force in 11 of the 25 jurisdictions.

[4] All assessments are available at www.bis.org/bcbs/implementation/l2.htm.

[5] See www.bis.org/publ/bcbs240.htm. Following the publication of the report, the Committee commenced a second hypothetical test portfolio exercise, which is more comprehensive than the 2012 exercise and includes 17 banks across nine jurisdictions. The results are expected around year-end 2013.

banking book in July 2013.[6] Both studies indicate considerable variation across banks in the risk weighting of assets, even for identical hypothetical test portfolios. While some variation in RWAs is natural and desirable, reflecting differences in banks' asset composition, business models and risk preferences, there is also material variation driven by diversity in bank and supervisory practices that diminishes the comparability of reported regulatory capital ratios and could be harmful to the international level playing field.

2.2 Quantitative impact assessment of Basel III

Since 2010 the Basel Committee has periodically monitored the progress of a sample of banks in its member jurisdictions in adjusting to the minimum Basel III requirements for capital and liquidity. The banking system as a whole continues to build its capital and is making substantial progress towards meeting the full set of fully phased-in minimum Basel III capital requirements ahead of the 2019 deadline.[7] In the six months to December 2012, the average Common Equity Tier 1 (CET1) capital ratio of large internationally active banks rose from 8.5% to approximately 9% of RWAs. In addition, the aggregated capital shortfall of those banks that still have capital ratios below the fully phased-in 2019 CET1 requirements continues to drop: the shortfall is now well below half the aggregate annual profits of the industry (which in 2012 totalled over EUR 400 billion). Despite this progress, there remain major challenges as the strengthening in capital has been uneven and some banks still need significant repair of their balance sheets. Given the challenging global economic environment, national authorities must remain particularly vigilant to deterioration in banks' asset quality in order to ensure further improvement in capital adequacy.

2.3 Completing the Basel framework

The core components of the Basel III capital framework were finalised in 2010. Since then, the BCBS has substantially completed the remaining components. The most recent such development has been the endorsement on 6 January 2013 by the Group of Central Bank Governors and Heads of Supervision (GHOS) – the governing body of the BCBS – of the revised LCR, whose implementation is scheduled to commence in 2015.[8]

The BCBS is currently working to finalise the specification of the other key elements of the Basel III package – in particular, the leverage ratio (by early 2014) and the Net Stable Funding Ratio (by end-2014). Further work is also underway in relation to trading book capital requirements and securitisation. In June and July 2013, the BCBS issued consultative documents on the revised Basel III leverage ratio framework and its disclosure requirements (which will start from 1 January 2015);[9] capital treatment of bank exposures to central counterparties; non-internal model method for capitalising counterparty credit risk exposures;

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6 See www.bis.org/publ/bcbs256.htm.

7 The Committee's quantitative impact studies are based on a sample of over 200 banks, approximately half of which are large internationally active banks with Tier 1 capital in excess of €3 billion. The most recently published Basel III monitoring report is available at www.bis.org/publ/bcbs243.htm.

8 See http://www.bis.org/publ/bcbs238.htm.

9 The BCBS will undertake a quantitative impact study to ensure that the calibration of the leverage ratio, and its relationship with the risk-based framework, remains appropriate. Any final adjustments to the definition and calibration of the leverage ratio will be made by 2017, with a view to migrating to a Pillar 1 treatment on 1 January 2018.

capital requirements for banks' equity investments in funds; and LCR disclosure standards. The Committee will finalise these consultative documents after considering comments from stakeholders and interested parties.

As regards measures to reduce the excessive variation in RWAs across banks, the BCBS is actively considering possible reforms to improve the comparability of outcomes while ensuring an optimal balance between the risk-sensitivity of the framework and its complexity. Four types of policy options are under consideration: (i) improving public disclosures to aid the understanding of banks' calculations of RWAs; (ii) additional guidance on aspects of the Basel framework that could reduce variation; (iii) harmonisation of national implementation requirements; and (iv) constraints on the internal modelling choices for banks. The Committee is also conducting a more strategic review of the overall framework, and has issued a discussion paper seeking views on whether the current capital framework achieves the right balance between simplicity, comparability and risk sensitivity.

2.4 Strengthening risk management

Risk management is a critical first line of defence in enhancing the resilience of financial institutions. Work is ongoing by the FSB, standard-setting bodies (SSBs) and national authorities to strengthen risk management practices, including through increased regulatory and supervisory focus on firms' risk governance practices and additional guidance for national authorities and financial institutions.

The recent global financial crisis exposed a number of governance weaknesses that resulted in firms' failure to understand or manage the risks they were taking. To assess progress, the FSB completed in February 2013 a thematic peer review on risk governance, focusing on three key functions: the board, the firm-wide risk management function, and the independent assessment of risk governance.[10] The peer review found that, since the crisis, national authorities have taken several measures to improve regulatory and supervisory oversight of risk governance at financial institutions.[11] Nonetheless, more work remains: national authorities need to strengthen their ability to assess the effectiveness of a firm's risk governance, and more specifically its risk culture to help ensure sound risk governance through changing environments. The FSB is developing guidance for supervisors to assess risk culture at financial institutions and is expected to issue a report by the end of 2013.

The FSB peer review also asked supervisors to evaluate progress made by firms toward enhanced risk governance in seven areas. The evaluation found that many of the best risk governance practices at those firms are now more advanced than national guidance. This outcome may have been motivated by firms' need to regain market confidence rather than regulatory requirements. However, although many surveyed firms have made progress in the last few years, significant gaps remain in risk management. Drawing on these findings and on relevant guidance published by other organisations and SSBs, the peer review report identifies

[10] See http://www.financialstabilityboard.org/publications/r_130212.pdf.

[11] These measures included developing or strengthening existing regulation or guidance, raising supervisory expectations for the risk management function, engaging more frequently with the board and management, and assessing the accuracy and usefulness of the information provided to the board to enable effective discharge of their responsibilities.

a list of sound risk governance practices for national authorities and sets out other recommendations to further enhance the effectiveness of risk governance frameworks.

The BCBS continued to engage in initiatives that aim at strengthening risk management at banks. In June 2012, it issued *The internal audit function in banks*, replacing a 2001 document with revised supervisory guidance for assessing audit effectiveness. The new guidance addresses the supervisory authority's expectations of and relationship to the internal audit function as well as supervisory assessments. In March 2013, the Committee issued for consultation *External audits of banks*, which sets out the Committee's greater supervisory expectations of (i) more robust audit of banks and (ii) enhanced engagement between the audit committee and auditors and between auditors and supervisors. The FSB has asked the International Association of Insurance Supervisors (IAIS) to develop guidance on the external audit of insurers and a draft for consultation will be prepared during 2014.

In March 2013, the BCBS finalised guidelines on *Monitoring indicators for intraday liquidity management*, which are intended to allow banking supervisors to monitor a bank's management of its intraday liquidity risk; over time, they will also help supervisors better understand banks' management of this risk as well as their payment and settlement behaviour. In February 2013, the BCBS released *Supervisory guidance for managing risks associated with the settlement of foreign exchange transactions*. The guidance is an update that provides a more comprehensive and detailed view of the governance and management of settlement-related risks. In addition, to reduce principal risk, it promotes the use of payment-versus-payment arrangements where they are practicable. Finally, the BCBS published in June 2013 a consultative document on *Sound management of risks related to money laundering and financing of terrorism*. The proposed guidelines take into account the February 2012 recommendations set out in the Financial Action Task Force International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation.

Other SSBs have also issued guidance to strengthen risk management practices by market participants and their oversight by national authorities. The Joint Forum issued *Principles for the Supervision of Financial Conglomerates* in September 2012 that focus on the governance, capital, liquidity and risk management frameworks of financial conglomerates; these principles expand on and supersede the 1999 compendium of principles on this topic. The Joint Forum also issued in August 2013 a final report providing recommendations to policymakers and supervisors on mortgage insurance and a consultative report on longevity risk transfer markets.[12] The International Organisation of Securities Commissions (IOSCO) published in March 2013 the final report on *Principles of Liquidity Risk Management for Collective Investment Schemes*, which contains a set of principles against which both the industry and regulators can assess the quality of regulation and industry practices concerning liquidity risk management for collective investment schemes.[13]

National authorities have also been making efforts to strengthen the risk management practices of financial institutions in their jurisdiction – for example:

- In Australia, the prudential regulator (APRA) released a consultation package in May 2013 and is in the process of finalising a proposed cross-industry prudential standard on

[12] See http://www.bis.org/list/jforum/index.htm.

[13] See http://www.iosco.org/library/pubdocs/pdf/IOSCOPD405.pdf.

risk management. APRA also proposes to incorporate risk management requirements that are complementary to emerging international consensus on the lessons learned from the financial crisis.

- In the EU, the fourth Capital Requirements Directive (CRD IV) entered into force on 17 July 2013. The new rules, which will apply from 1 January 2014, strengthen the requirements regarding risk management practices and structures of credit institutions by putting in place clear rules and standards with regard to the role and independence of the risk management function and the overall risk oversight by boards.

2.5 Enhancing compensation practices

In 2011, the G20 Leaders called on the FSB to "undertake an ongoing monitoring and public reporting on compensation practices focused on remaining gaps and impediments to full implementation [of the *FSB Principles for Sound Compensation Practices and their Implementation Standards* (P&S)] and carry out an ongoing bilateral complaint handling process to address level playing field concerns of individual firms."

The second implementation progress report in this area was published in August 2013. [14] It focuses on remaining gaps and impediments to full implementation of the P&S and describes some of the remaining key challenges. The report finds that, while good progress continues to be made, more needs to be done by national authorities and firms to ensure that improvements are sustainable and compensation structures underpin prudent risk taking behaviour.

With all FSB member jurisdictions except two (Argentina and Indonesia) having completed the implementation of the P&S in national regulation or supervisory guidance, the focus now is on effective supervision and oversight of implementation of these rules by relevant firms. Trends reported by national authorities suggest that most compensation structures (e.g. percentage of pay that is deferred; deferral periods; use of equity as a form of compensation; use of maluses and clawbacks) are being revised to conform with the P&S. Further work is needed to promote good practices, particularly in areas such as the use of maluses and clawbacks, and on the identification criteria for material risk takers (MRTs) given the differences in approach and points of view by FSB jurisdictions. While disclosure of compensation structures has improved, it is still generally difficult for the public to reliably access easy to understand and consistent data for significant firms across jurisdictions.

The report notes that certain regulatory initiatives currently being implemented could materially change compensation structures in some FSB member jurisdictions. In particular, the adoption by the EU of CRD IV includes requirements on compensation structures that go beyond those in the P&S.

Several authorities note that firms still express some level playing field concerns with regard to jurisdictions that may not have fully implemented the P&S or that do not supervise their firms adequately for this purpose. At the same time, however, national authorities have yet to see any real evidence that the implementation of the P&S has impeded or diminished the ability of supervised institutions to recruit and retain talent. The Bilateral Complaint Handling

[14] See http://www.financialstabilityboard.org/publications/r_130826.pdf.

Process, which the FSB initiated for the purposes of addressing level playing field concerns,[15] has not so far been activated by firms in FSB member jurisdictions.

The FSB will continue to monitor and report on the implementation of the P&S and promote good practices among supervisors and firms, particularly in areas such as the use of maluses and clawbacks. As part of this, the FSB will survey and compare the range of practices on MRTs across its membership, with a view to identifying good practices while recognising firms' differences and the need for proportionality. The FSB will also continue to engage with the industry on trends and remaining challenges in this regard.[16]

3. Ending "Too-Big-To-Fail"

At the Pittsburgh Summit in 2009, G20 Leaders called on the FSB to propose measures to address the systemic and moral hazard risks associated with systemically important financial institutions (SIFIs). SIFIs are institutions of such size, market importance and interconnectedness that their distress or failure would cause significant dislocation in the financial system and adverse economic consequences. The "too-big-to-fail" (TBTF) problem arises when the threatened failure of a SIFI leaves public authorities with limited options but to bail it out and pass on the costs of failure to taxpayers. The knowledge that this can happen encourages SIFIs to take excessive risks and represents a large implicit public subsidy of private enterprise.

At the Seoul Summit in 2010 the G20 leaders endorsed the FSB framework for reducing the moral hazard posed by SIFIs (SIFI Framework).[17] This framework addresses the TBTF issue by reducing the probability and impact of SIFIs failing. It comprises requirements for assessing the systemic importance of institutions, for additional loss absorbency, for increased supervisory intensity, for more effective resolution mechanisms, and stronger financial market infrastructure.

Substantial progress has been made in implementing this framework.

- **Assessment and designation:** Methodologies for assessing the global systemic importance of banks (G-SIBs)[18] and insurers (G-SIIs)[19] have been issued and 28 G-SIBs and nine G-SIIs have been designated as such. Higher loss-absorption capacity, more intensive supervision and resolution planning requirements will apply to all these institutions.
- **Additional loss absorbency:** A new strengthened capital regime requiring additional going-concern loss absorption capacity for the G-SIBs has been finalised and in many cases the G-SIBs are building the extra capital ahead of schedule. Since the end of

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15 See http://www.financialstabilityboard.org/activities/compensation/bchp.htm.

16 The FSB organised a workshop in November 2012, which was attended by supervisors from FSB member institutions as well as senior executives from G-SIBs and consulting firms. The workshop findings can be found at http://www.financialstabilityboard.org/publications/r_130124.pdf.

17 See http://www.financialstabilityboard.org/publications/r_101111a.pdf.

18 See http://www.bis.org/publ/bcbs255.htm.

19 See http://www.iaisweb.org/20G-SIIs-988.

2009, the G-SIBs have increased their common equity capital by about US$500 billion, amounting to almost 3% of their RWAs.

- **Supervisory intensity:** Recommendations for enhanced supervision and heightened supervisory expectations for risk management, risk aggregation and risk reporting have been developed and are now being implemented.
- **Effective resolution:** In 2011 the G20 endorsed the *Key Attributes of Effective Resolution Regimes for Financial Institutions (Key Attributes)* as a new international standard for resolution of financial institutions. Since then, guidance has been issued on resolution strategies for G-SIBs. The approaches to deal with the resolution of financial market infrastructure (FMI) and insurers, as well as the protection of client assets in resolution, will be finalised by the end of this year.
- **Strengthened core infrastructure:** Good progress has also been made in strengthening core financial market infrastructure (such as central counterparties) to address risks of contagion through the financial system.

3.1 Improving the capacity to resolve systemic institutions

A first FSB peer review of national resolution regimes using the *Key Attributes* as a benchmark was completed this year.[20] The review found that substantial headway is being made in the United States with the adoption of the Dodd-Frank Wall Street Reform and Consumer Protection Act and amendments to resolution regimes in other FSB jurisdictions, including in Australia, France, Germany, Japan, Netherlands, Spain, Switzerland and the United Kingdom (UK). In the EU, the Bank Recovery and Resolution Directive is expected to be adopted later this year. Its implementation within a year of adoption will be an important step towards implementation of the *Key Attributes* in EU member states. However, further legislative measures are necessary in many FSB jurisdictions to implement the *Key Attributes* fully. Important areas where jurisdictions need to act relate to the adoption of bail-in powers and other resolution tools, powers for cross-border cooperation and the recognition of foreign resolution actions.

The thematic peer review showed that resolution regimes are most advanced for banks and progressively less so for insurers, securities or investment firms and FMIs, where both mandates and powers fall well short of the standards in the KAs. The FSB, in conjunction with relevant standard setters, is developing guidance on how the *Key Attributes* should be interpreted and implemented with respect to the resolution of FMIs, the resolution of insurers, and the protection of client assets in resolution. The guidance has been developed as Annexes to the *Key Attributes* and will be finalised by end-2013.

So that all financial institutions that could be systemically significant in failure can be resolved without exposing the taxpayers to the risk of loss, jurisdictions need to have in place effective resolution regimes, consistent with the substance and cross-sectoral scope of the *Key Attributes*. Further legislative reforms to resolution regimes should therefore be a priority area for G20 governments.

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[20] See http://www.financialstabilityboard.org/publications/r_130411a.pdf.

As jurisdictions are working to put the necessary legislative regimes in place, authorities have made considerable progress in developing resolution strategies and identifying conditions relating to firms' legal, operational and financial structures and their effect on resolvability. The resolution strategies that are being developed for global institutions are based broadly on two stylised approaches: "single point of entry resolution", in which resolution powers are applied to the top of a group by a single national resolution authority and "multiple point of entry resolution" in which resolution tools are applied to different parts of the group by two or more resolution authorities acting in a coordinated way.

To support the recovery and resolution planning work, the FSB in July 2013 released guidance on (i) the development of resolution strategies and plans; (ii) identification of the critical functions that make a firm systemically relevant, and (iii) triggers for recovery actions and stress scenarios that are relevant for G-SIFI recovery plans.[21] This guidance will provide a framework for the resolvability assessments within Cross-border Crisis Management Groups (CMGs), established now for all the G-SIBs, to assess the feasibility of their work to date on the high-level resolution strategies and the operational resolution plans that build on these high-level strategies.

Work on cooperation agreements that set out a framework to support the cross-border implementation of resolution strategies and plans is progressing, albeit more slowly than originally planned. To be effective, these agreements should be institution-specific and not general terms agreements. Progress on this front should be helped by the full implementation of the legal framework condition for cross-border cooperation set out in the *Key Attributes* and of the additional guidance on Information Sharing for Resolution Purposes set out in a new Annex to the *Key Attributes*.

As resolution planning work has progressed, authorities have identified a number of issues that remain to be addressed for authorities and market participants to have confidence that resolution strategies and plans can be implemented in practice. Further work is required on the legal, operational and financial structures of SIFIs, including in particular the availability of gone-concern loss absorbing capacity (GLAC) in sufficient amounts and at appropriate locations; establishing clarity on the ranking of claims in the creditor hierarchy and the implications for resolution; making resolution actions effective across borders; avoiding detrimental large scale termination of financial contracts based on early termination and cross-default rights when a firm enters resolution; maintaining the operational continuity of critical services and market access of firms in resolution, including access of the firm in resolution to services of FMIs; and improving firms' information systems and data availability to support resolution.

Changes to firm structures, regulatory policies and, in cases, legal frameworks will be necessary to address remaining impediments to resolvability. The Resolvability Assessment Process, which will be launched in early 2014, will help inform the development of the further regulatory steps and requirements in these regards.

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[21] See http://www.financialstabilityboard.org/press/pr_130716.pdf. The documents were issued for public consultation in November 2012.

3.2 Identifying SIFIs and applying prudential measures to reduce their probability of failure

The FSB SIFI framework requires that the FSB and national authorities, in consultation with the standard setting bodies, and drawing on relevant indicators, identify and apply heightened prudential standards to global systemically important financial institutions. The framework recognises that SIFIs vary in their structures and activities, and that systemic importance and impact upon failure can vary significantly across sectors. The methodologies to identify G-SIFIs and the policies that apply to them therefore seek to reflect the nature and degree of risks they pose to the global financial system. The methodology to identify systemically important banks has been updated, and substantial progress has been made to extend the SIFI framework to financial institutions beyond banks.

3.2.1 Systemically important banks

The BCBS finalised and published its assessment methodology to identify G-SIBs in November 2011. In July 2013, the Committee published an updated methodology document that adjusted the framework for some technical issues that had been identified during the initial exercises to determine the list of G-SIBs.[22] The methodology is based on twelve indicators for five drivers of systemic importance: size, cross-jurisdictional activity, interconnectedness, complexity and substitutability/financial institution infrastructure.

Based on this methodology, the FSB and the BCBS identified an initial group of G-SIBs in November 2011. This group is updated annually based on new data, and published by the FSB each November. The current list, published in November 2012, includes 28 global banks[23] that are grouped into four buckets of increasing systemic importance, which correspond to increasing levels of additional required loss absorbency, ranging from 1 to 2.5 per cent of risk-weighted assets, including an empty bucket of 3.5 per cent to discourage further systemicness.[24] The additional loss absorbency requirement is to be met with Common Equity Tier 1, the highest quality form of capital.[25] The requirements for G-SIBs will be phased in - initially for those banks identified as G-SIBs in November 2014 – commencing in 2016 with a view to full implementation in 2019. The BCBS progress report on Basel III implementation indicates that many G-SIBs are well on their way to meeting these higher loss absorbency requirements.[26]

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[22] See http://www.bis.org/publ/bcbs255.pdf. To help banks and jurisdictions prepare for the implementation of the G-SIB framework, the Basel Committee intends to finalise and publish, by November 2013, certain elements of the regime one year in advance of timeline set out in the November 2011 publication. These elements will enable banks to calculate their scores and higher loss absorbency requirements using end-2012 data, prior to the requirements coming into effect based on end-2013 data.

[23] Of these banking groups, 8 are North American, 16 are European, and 4 are Asian.

[24] If the empty bucket should become populated in the future, a new bucket will be added, in increments of 1% of risk-weighted assets, to maintain incentives for banks to avoid becoming more systemically important.

[25] Currently, four G-SIBs are in the fourth bucket, corresponding to a 2.5% additional loss absorbency requirement; 2 G-SIBs in the third bucket (2%); 8 G-SIBs in the second bucket (1.5%), and 4 G-SIBs in the first bucket (1%). On average for these institutions, the additional loss absorbency requirement corresponds to an increase of more than 20% over the minimum and buffer capital required under Basel III.

[26] See http://www.bis.org/publ/bcbs260.pdf.

Following the publication of the G-SIB framework in November 2011, the G20 Leaders asked the BCBS and the FSB to work on modalities to extend expeditiously the G-SIFI framework to domestic systemically important banks (D-SIBs). In October 2012, the BCBS finalised and published its framework for dealing with D-SIBs.[27] The D-SIB framework focuses on the impact that the distress or failure of banks will have on the domestic economy. It consists of twelve principles to guide the assessment of systemic importance of domestic banks and the application of higher loss absorbency requirements to identified D-SIBs, in a way that allows for appropriate national discretion to accommodate structural characteristics of domestic financial systems. Jurisdictions are proceeding with the implementation of the D-SIB principles and, to help ensure that appropriate and effective frameworks for D-SIBs are in place across jurisdictions, the BCBS will review them as part of its Basel III RCAP.

3.2.2 Systemically important insurers

The IAIS developed an assessment methodology to identify G-SIIs that is based on industry specific indicators to reflect the drivers of systemic importance in the insurance sector.[28] The drivers of systemic importance are: size, global activity, interconnectedness, non-traditional/non-insurance activities (NTNI), and substitutability. Higher weight is given to NTNI activities and interconnectedness, the two categories which capture the potential negative externalities of insurance companies on the rest of the system and hence the importance of insurers for financial stability. Based on this methodology, the FSB, in consultation with the IAIS and national authorities, has identified in July 2013 9 life and composite insurers as G-SIIs. A decision on the G-SII status of major reinsurers will be made in July 2014.

G-SIIs will be subject to a set of policy measures consistent with the SIFI Framework, comprising recovery and resolution planning, enhanced group-wide supervision and higher loss absorbency requirements. In the absence of a global capital standard as a basis, the IAIS will as a first step develop straightforward, backstop capital requirements for all group activities, including non-insurance subsidiaries. The IAIS will finalise these requirements by the G20 Summit in 2014.[29] Building on the above requirements, the IAIS will then develop by end 2015 implementation details for HLA requirements for G-SIIs, which will need to be met by highest quality capital and will be targeted in particular to non-traditional, non-insurance activities. HLA requirements will apply as from January 2019 to those G-SIIs identified in November 2017 on the basis of the IAIS methodology.

3.2.3 Systemically important non-bank financial entities

The FSB, in consultation with IOSCO, is currently working on assessment methodologies for identifying non-bank non-insurance (NBNI) G-SIFIs. The proposed assessment methodologies will be prepared by the end of this year and will be issued for public consultation. The methodologies should capture different types of systemic impact posed by

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[27] See http://www.bis.org/publ/bcbs233.pdf.

[28] See http://www.iaisweb.org/G-SIIs-988.

[29] The IAIS is also planning to develop a comprehensive, group-wide supervisory and regulatory framework for internationally active insurance groups (IAIGs), including a quantitative capital standard.

entities in each type or sector, while maintaining consistency across the spectrum of non-bank financial entities.

3.3 Improving the intensity and effectiveness of SIFI supervision

The level of supervision must be commensurate with the potential risk that firms pose to the financial system. The FSB issued its first recommendations for enhanced supervision of financial institutions, in particular SIFIs, in October 2010. This report underscored the key preconditions for effective supervision, including the needs for (i) strong and unambiguous mandates; (ii) independence to act; (iii) sufficient quality and quantity of resources; and (iv) supervisors having a full suite of powers to execute on their mandate. Some progress has been made in this regard, but findings from the International Monetary Fund (IMF)-World Bank Financial Sector Assessment Program (FSAP) reveal that significant weaknesses continue to exist.[30] To deliver high quality supervision, G20 authorities must therefore continue to take steps to ensure that resource needs at supervisory authorities are adequately addressed and best practices for ensuring supervisory independence and accountability are fully implemented.

Subsequent recommendations in 2011 and 2012 strengthened the supervisory expectations for firms' risk governance and internal controls, risk management functions, risk aggregation and risk reporting capabilities.[31] A number of these recommendations have been implemented and, collectively, have raised the bar for both supervisors and SIFIs. In light of these recommendations, the BCBS, IAIS and IOSCO have strengthened their core principles for effective supervision which collectively address many of the early recommendations for enhanced supervision. To remedy the gaps in information technology and management information systems highlighted during the crises, the FSB recommended the development of principles for effective risk data aggregation and risk reporting. G-SIBs are required to meet the BCBS Principles for Effective Risk Data Aggregation and Risk Reporting by 2016.[32]

Cross-border supervisory cooperation and coordination also needs to be intensified for the agreed supervisory approaches and methods to be effective. A key element of the SIFI Framework is for home jurisdictions of G-SIFIs to enable a sharing of information for the purpose of rigorous co-ordinated assessments on the risks facing the G-SIFI through international core supervisory colleges, and more work is needed to achieve this.

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[30] In particular, recent FSAPs reveal that only 25% of FSB jurisdictions are fully compliant with the BCBS principles on regulatory independence and resources (with an additional 50% largely compliant); no FSB jurisdictions are fully compliant with the relevant IAIS principles (with 19% largely compliant); and only 8% are fully compliant with the relevant IOSCO principles (with 33% largely compliant). In these core areas for supervisory effectiveness, achieving full compliance with the relevant international standards is particularly important.

[31] See *Intensity and Effectiveness of SIFI Supervision* by the FSB (November 2010, November 2011, November 2012). The expectation is that firms should have 'strong' and not merely 'good' risk management, and that high standards of risk management should be fully integrated into a firm's culture and compensation practices.

[32] See http://www.bis.org/publ/bcbs239.pdf. Implementation of these principles at the firm-wide, legal entity, and business unit levels is critical to the effective risk management of the firm, as well as for the effective implementation of the resolution requirements of the framework, such as recovery and resolution plans. Supervisory programs for G-SIBs now include regular assessments of progress on implementation of these principles, to ensure resources remain committed to this effort through the cycle.

3.4 Addressing data gaps

This initiative develops proposals to implement in incremental and sequenced stages a common data template for G-SIBs to address key information gaps and to provide the authorities with a strong framework for assessing potential systemic risks.

The initial stage of the initiative (Phase 1), consisting of a common data template for collecting and pooling consistent information on the bilateral counterparty credit exposures as well as the aggregate consolidated international exposures of G-SIBs, was implemented in March 2013. The data templates have been rolled out to industry and data collection has started. A multilateral framework was agreed by jurisdictions to provide the governance basis for an international data hub hosted by the BIS to pool and service the collected data and share reports among the home supervisory authorities of G-SIBs participating in Phase 1. The implementation of Phase 1 provides a foundation and operational experience for the next stages of the project.

Data extensions in Phase 2 will include a common data template for bilateral funding sources, and in Phase 3, a common data template for a harmonized consolidated balance sheet. These extensions will complete and enhance the identification of common exposures and other interconnections among the reporting firms. The draft templates are currently being discussed with the industry. The objective is to finalize the new templates by the end of 2013 and to plan with the industry a start of the implementation of Phase 2 in the course of 2014, to be followed by that of Phase 3 one year after.

In parallel, work is underway among G-SIB jurisdictions to provide the legal gateway to extend the sharing of relevant reports to other eligible authorities and international financial institutions. At this stage, an extension of the sharing of reports in Phase 2 to national central banks with macro-prudential responsibilities in G-SIB home jurisdictions, as approved by the FSB in April 2013, will be possible pending some limited amendments to the multilateral framework governing the sharing between the home supervisory authorities in Phase 1. Additional work will consider options regarding the form and contents of further sharing with macro-prudential authorities other than central banks, host authorities and international financial institutions.

The FSB will review progress made on Phase 2 and Phase 3 in March 2014.

4. Transforming shadow banking

Non-bank financial intermediation provides a valuable alternative to banks in providing credit in support of economic activity. The 2007 financial crisis however revealed systemic risks from important fault lines in the "shadow banking system" [33] that had lain mostly unrecognised during its rapid expansion. Key amongst these were a heavy reliance on short-term wholesale funding, a variety of incentives problems in securitisation that weakened lending standards, and a general lack of transparency that hid growing amounts of leverage, maturity and liquidity transformation. When risks manifested, these factors caused credit intermediation through the shadow banking system to come to a dramatic halt.

[33] The FSB has defined the "shadow banking system" as "credit intermediation involving entities and activities (fully or partially) outside the regular banking system".

The G20 at its Cannes Summit in November 2011 requested the FSB to develop policy measures to address these risks, extending the regulatory perimeter where needed to protect financial stability as risky activities shift to the unregulated sector when new regulations on banks come into effect. To these ends, the FSB has followed a two-pronged strategy. First, it has created a **monitoring framework** to enhance national authorities' ability to track developments in the shadow banking system with a view to identifying the build-up of systemic risks and enabling corrective actions where necessary. Second, the FSB has coordinated the development of policies in **five areas where oversight and regulation needs to be strengthened** to reduce systemic risks:

(i) Mitigating risks in banks' interactions with shadow banking entities;

(ii) Reducing the susceptibility of money market funds (MMFs) to "runs";

(iii) Improving transparency and aligning incentives in securitisation;

(iv) Dampening pro-cyclicality and other financial stability risks in securities financing transactions such as repos and securities lending; and

(v) Assessing and mitigating financial stability risks posed by other shadow banking entities and activities.

4.1 Strengthening oversight of the shadow banking system

An important lesson from the crisis is the need for authorities to establish system-wide monitoring arrangements, capable of assessing sources of systemic risks both inside and outside the part of financial systems traditionally subject to prudential regulation. To this end, the FSB began conducting annual monitoring exercises to assess global trends and risks of the shadow banking system in 2011. The result of its second annual monitoring exercise was published in November 2012[34], and the third monitoring exercise result is expected to be published in November 2013. In the 2012 exercise, coverage was broadened to include 25 jurisdictions (all 24 FSB jurisdictions and Chile), compared with 11 jurisdictions in 2011. The monitoring therefore captures jurisdictions representing 83% of global gross domestic product and 90% of global financial system assets. The primary focus of the exercise is on a "macro-mapping", based on national Flow of Funds and Sector Balance Sheet data, that looks at all non-bank financial entities and activities to ensure the information set is sufficiently broad to cover the areas where shadow banking-related risks may arise. The 2012 monitoring exercise also added new insights on interconnectedness between banks and non-bank financial entities as well as on a specific non-bank financial subsector, namely finance companies.

The FSB intends to improve the monitoring exercise by gathering and analysing more granular balance sheet data, in particular measuring more precisely the extent to which non-bank entities are involved in credit intermediation, as well as expanding activity-based and risk-based monitoring. Implementation of enhanced data reporting and disclosure requirements for shadow banking as recommended by the FSB (see next section) will also help in this regard.

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[34] See http://www.financialstabilityboard.org/publications/r_121118c.pdf.

Meanwhile, several jurisdictions have started to publish detailed analyses of their respective shadow banking system, leveraging on the FSB annual shadow banking monitoring exercise. For example, central banks of Australia, Canada and Germany have published detailed analysis of shadow banking system in their jurisdiction as part of their regular financial stability review reports.[35] The central bank of the Netherlands has also published a working paper which sets out detailed analysis of its shadow banking system to explain the Dutch results in the FSB's Global Shadow Banking Monitoring Report 2012.[36] Similar exercise has been conducted by non-FSB member jurisdictions, some of which have been published.[37]

4.2 Strengthening regulation of the shadow banking system

The policy work to prevent the re-emergence of systemic risks from shadow banking has focused on the following five areas.

(i) **Mitigating risks in banks' interactions with shadow banking entities -** To reduce the spill-over of risks from the shadow banking system to the core banking system, the BCBS is developing: (i) guidance to improve the international consistency of the *scope of consolidation* for prudential regulatory purposes; (ii) supervisory framework for measuring and controlling large exposures; and (iii) a more internationally consistent and risk sensitive capital treatment for banks' investment in equity of funds, including funds engaged in shadow banking activities. On (ii) and (iii), the BCBS has issued proposals for public consultation and will finalise the work by the end of 2013.[38] It will review the capital treatment of back-up liquidity lines to funds as necessary and will also complete its work on (i) in 2014.

(ii) **Reducing the susceptibility of money market funds (MMFs) to "runs" -** In order to address the demonstrated systemic risks of contagious investor runs on a large segment of MMFs, IOSCO has developed policy recommendations that provide the basis for common standards for the regulation and management of MMFs across jurisdictions in October 2012.[39] The FSB has endorsed the IOSCO recommendations, including the requirement that MMFs that offer stable or constant net asset value (NAV) to their investors should be converted into floating NAV where workable. Where such conversion is not workable, the FSB believes that the safeguards required to be introduced to reinforce stable NAV MMFs' resilience to runs should be functionally equivalent in effect to the capital, liquidity, and other prudential requirements on banks that protect against runs on their deposits.[40]

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[35] See: Reserve Bank of Australia (2012) *A Closer Look at the Shadow Banking System in Australia*, Financial Stability Review, March; Toni Gravelle et.al. (2013) *Monitoring and Assessing Risks in Canada's Shadow Banking Sector*, Financial Stability Review, June; and Deutsche Bundesbank (2012) *The Shadow Banking System: Small in Germany but globally connected*, Financial Stability Review.

[36] Menno Broos et.al. (2012) *Shadow Banking: An Explanatory Study for the Netherlands*, DNB Occasional Studies, Vol.10 No.5.

[37] For example, see Brian Godfrey et.al. (2012) *Measuring Shadow Banking using Granular Data*, Central Bank of Ireland Quarterly Bulletin, October.

[38] See http://www.bis.org/publ/bcbs246.pdf for (ii), and http://www.bis.org/publ/bcbs257.pdf for (iii).

[39] See http://www.iosco.org/library/pubdocs/pdf/IOSCOPD392.pdf.

[40] See http://www.financialstabilityboard.org/publications/r_121118.pdf.

National and regional authorities are currently reviewing their existing approaches to regulating MMFs in light of the IOSCO recommendations. In the US, home to the world's largest MMF market, the Financial Stability Oversight Council (FSOC) issued for consultation in November 2012 proposed recommendations to support the implementation of structural reforms to mitigate the vulnerability of MMFs to runs.[41] The Securities and Exchange Commission (SEC) also recently proposed rules that would reform the way that MMFs operate in order to make them less susceptible to runs.[42]

In the EU, the second largest MMF market, the European Commission organised in 2012 a public consultation on the asset management regulatory framework including possible ways to strengthen the MMF's resilience to systemic risks (e.g. investor runs).[43] An impact assessment has been prepared with a view to make a proposal for a MMF regulation in the second half of 2013. Meanwhile, the European Systemic Risk Board (ESRB) also published recommendations on stable NAV MMFs in December 2012 that include mandatory conversion of stable NAV MMFs to floating NAV MMFs in order to reduce the shareholder's incentive to run when the MMF has experienced a loss.[44]

IOSCO will launch a peer review process in 2014 to examine the implementation by national/regional authorities of its recommendations in this area. The results will be reported to the FSB so that they can be included in the overall monitoring and reporting of national/regional implementation progress in the shadow banking area.

(iii) **Improving transparency and aligning incentives in securitisation** – IOSCO issued a report in November 2012 that took stock of the implementation of regulatory reforms, especially those related to (i) retention requirements, and (ii) measures that enhance transparency and standardisation of securitisation products, and set out further policy recommendations in these areas. These recommendations seek to facilitate convergent implementation across jurisdictions of approaches to align incentives, in particular regarding risk retention requirements. Based on the recommendations, IOSCO will undertake a peer review in 2014 to assess the implementation of incentive alignment approaches in its member jurisdictions and will report the results to the FSB. The resumption of orderly securitisation markets is a goal of the wider financial reform program, and the FSB, in collaboration with other SSBs, will continue to review and address regulatory impediments in this regard.

(iv) **Dampening procyclicality and other financial stability risks in securities financing transactions** - The FSB published a consultative document in November 2012 that sets out proposed policy recommendations for securities financing transactions so as to reduce the risks associated with the heavy dependence by the shadow banking system on this form of short-term wholesale funding.[45] Based on the public responses received, the FSB has finalised most of its policy recommendations in August 2013.[46] These include

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41 See http://www.treasury.gov/press-center/press-releases/Pages/tg1764.aspx.

42 See http://www.sec.gov/rules/proposed/2013/33-9408.pdf.

43 See http://ec.europa.eu/internal_market/consultations/2012/ucits_en.htm.

44 http://www.esrb.europa.eu/pub/pdf/recommendations/2012/ESRB_2012_1.en.pdf?4e30873f97c21330632e252d505927c8

45 See http://www.financialstabilityboard.org/publications/r_121118b.pdf.

46 See http://www.financialstabilityboard.org/publications/r_130829a.pdf.

standards and processes for data collection and aggregation at the global level to enhance transparency of securities financing markets, which will be taken forward by a new FSB data expert group by the end of 2014.

The FSB has also published consultative proposals on (i) minimum standards for methodologies used by market participants in calculating the "haircuts (margins)" that limit the amount of financing that can be provided against a given security, and (ii) a framework of numerical haircut floors intended to prevent the erosion of margins below minimum levels when non-banks obtain leverage through securities financing transactions backed by non-government collaterals.[47] These measures would help reduce excessive leverage and dampen pro-cyclicality in such financing markets. The FSB will conduct a comprehensive quantitative impact assessment of these proposals and will complete its work on the proposed recommendations on minimum haircuts by spring 2014.

(v) **Assessing and mitigating systemic risks posed by other shadow banking entities and activities** - Recognising that shadow banking entities and activities take a variety of forms and evolve over time, the FSB has developed a forward-looking high-level policy framework for adoption by authorities to detect and assess the sources of financial stability risks from shadow banking in the non-bank financial space, and apply appropriate policy measures where necessary to mitigate these risks. The framework was issued for public consultation in November 2012[48] and has been finalised based on the consultative responses in August 2013.[49] The framework consists of three elements: (i) assessment of shadow banking risks in non-bank financial entities based on economic functions (or activities); (ii) adoption of regimes based on overarching principles for taking regulatory actions on non-bank financial entities that pose threat to financial stability from shadow banking, as well as policy tools from a menu of optional policies (policy toolkit) for each economic function to mitigate identified risks; and (iii) information-sharing among authorities through the FSB process to maintain consistency across jurisdictions in applying the policy framework. The FSB will develop detailed procedures for information-sharing by March 2014 so that it would be in a position to start a peer review process of national frameworks by 2015.

5. Creating continuous markets – OTC derivatives reforms

In response to concerns about systemic risks in over-the-counter (OTC) derivatives markets, in 2009 and subsequent meetings the G20 Leaders agreed to a comprehensive reform agenda to improve transparency in these markets, mitigate systemic risk, and protect against market abuse.

To achieve these objectives, the G20 agreed that by end-2012: all OTC derivative contracts should be reported to trade repositories (TRs); all standardised contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central

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[47] See Annex 2 of http://www.financialstabilityboard.org/publications/r_130829b.pdf.

[48] See http://www.financialstabilityboard.org/publications/r_121118a.pdf.

[49] See http://www.financialstabilityboard.org/publications/r_130829b.pdf.

counterparties (CCPs); and non-centrally cleared contracts should be subject to higher capital requirements and minimum margining requirements should be developed.

Substantial progress has been made in implementing this agenda, as described in more detail by the FSB in a separate summary report to the Summit and in its latest progress report on implementation of reforms.[50] Currently, over half of FSB member jurisdictions now have legislative frameworks in place to enable all reform commitments to be implemented. Jurisdictions are moving ahead most rapidly in requirements for transactions to be reported to TRs: by the start of 2014, three-quarters of FSB member jurisdictions intend to have legislation and regulation adopted, and a little over half expect to have specific requirements in force. These jurisdictions include most of the largest OTC derivatives markets. Although central clearing is moving forward more slowly, frameworks for adopting central clearing requirements are in place in most of the largest derivatives markets with concrete rules now coming into force. Progress in execution of standardised contracts on exchanges or electronic trading platforms, where appropriate, however, continues to lag behind and authorities should renew their focus on implementing this commitment.

International guidance to assist with implementation of reforms is largely complete. Final international standards for banks' capitalisation of counterparty exposures arising from centrally cleared derivatives and for minimum margin requirements for non-centrally cleared derivatives have now also been proposed or agreed. Important work is being undertaken by CPSS-IOSCO and the FSB who have recently proposed a comprehensive set of guidance on recovery and resolution for FMIs, including CCPs.

The recent Bank for International Settlements (BIS)-coordinated assessment of the expected macroeconomic impact of OTC derivatives market reforms estimates that there are likely to be long-run net benefits from implementation of the agreed OTC reforms. The costs of reform arising from higher capital and collateral requirements are estimated to be more than offset by the benefit that flows from a lower frequency of financial crises, due to reforms that reduce counterparty exposures through more widespread central clearing and more comprehensive collateralisation.[51] This study notes that benefits will likely be maximised where the agreed reforms are most fully implemented, and in particular where as many transactions as possible are standardised and centrally cleared. This should provide further impetus for jurisdictions to ensure these reforms are speedily and comprehensively implemented.

With many jurisdictions now implementing specific requirements for market participants, clarity over the cross-border application of regulations is crucial for all stakeholders. The OTC Derivatives Regulators Group (consisting of market regulators from jurisdictions with large OTC derivatives markets) has been working to resolve remaining cross-border conflicts, inconsistencies, gaps and duplicative requirements, and has provided a report to the Summit on its progress and agreements reached.[52] Given the likely differences in the detail of

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[50] See http://www.financialstabilityboard.org/press/pr_130902a.pdf.

[51] The study assumes sufficient collateral will be available to fulfil the requirements of all regulatory reforms currently planned. This assumption is based on BCBS QIS data and studies and a May 2013 report by the Committee on the Global Financial System (CGFS) that found no evidence or expectation of any lasting or widespread scarcity of such assets in global financial markets. See *Asset Encumbrance and the Demand for Collateral Assets*, available at http://www.bis.org/publ/cgfs49.pdf.

[52] See http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/odrgreport.pdf.

jurisdictions' reform implementation, focusing decisions around substituted compliance or equivalence/recognition on comparisons at a very granular level will not be helpful. Instead, assessments should be made based on whether jurisdictions' regulatory regimes achieve similar outcomes.

The FSB's most recent OTC derivatives progress report reviewed market participants' practical readiness to meet the requirements of reforms as they are implemented, concluding that participants in general appear to be making good progress in their preparations. Market participants are more advanced in their readiness where regulatory regimes and requirements are more settled; in contrast, regulatory uncertainty has held back the finalisation of preparations by some market participants.

Looking forward, some areas where further analysis and monitoring is needed include:

- the potential for concentration of activity and services within a limited number of intermediaries, and market innovations (such as collateral transformation or futurisation) that may develop in response to the changed regulatory environment;
- the scope for more products to be standardised and shifted into CCPs and platforms, and additional risk mitigants where activity remains outside such infrastructure;
- steps to ensure that authorities can make full use of the data collected by TRs in fulfilling their financial stability mandates; to assist in this an FSB feasibility study on approaches to the aggregation of TR data is underway;
- developments in cross-border activity, and whether more is needed to ensure cooperative oversight of this market.

The FSB will publish a further progress report by April 2014.

6. Creating continuous markets – other market reforms

6.1 Reforming financial benchmark-setting

The G20 Finance Ministers and Central Bank Governors April Communique asked the FSB to coordinate and guide work on the necessary reforms to short-term interest rate benchmarks and to report on progress towards oversight and governance frameworks for financial benchmark reform for consideration at the Summit.

The FSB established in July 2013 an Official Sector Steering Group (OSSG), co-chaired by Martin Wheatley, CEO of the UK's Financial Conduct Authority, and Jeremy C. Stein, Member, Board of Governors of the Federal Reserve System. The OSSG, which comprises senior officials from central banks and regulatory agencies, will focus its work on the interest rate benchmarks that are considered to play the most fundamental role in the global financial system.

The FSB asked the OSSG to review the standards and principles for sound benchmarks developed by the relevant standard setting bodies, with a view to recommending to the FSB whether adoption or endorsement of a single consolidated set of principles would be desirable. Following the recommendation of the OSSG, the FSB has endorsed the IOSCO

Principles for Financial Benchmarks published in July 2013 which cover the important issues of benchmark governance, integrity, methodology, quality and accountability.[53]

The OSSG's future work programme includes:

- **Recommendations for conducting assessments of the governance and processes that relate to existing interest-rate benchmarks using the endorsed IOSCO Principles.** Assessing the relevant benchmarks against internationally agreed standards is intended to demonstrate to the market and the general public that the deficiencies in benchmark design and the absence of robust governance processes that contributed to past abuses involving these benchmarks are being effectively addressed. The FSB has accepted the OSSG recommendation that IOSCO be commissioned to conduct an initial review of the most widely used existing interest rate benchmarks against its Principles. The OSSG will report back to the FSB on the outcome of these reviews by June 2014. The assessment process should provide for public dissemination of its findings.
- **Encouraging the private sector to identify additional benchmark rates.** As requested by the FSB, the OSSG is establishing a Market Participants Group (MPG). The MPG is chaired by Darrell Duffie, Dean Witter Professor of Finance at Stanford University. The Vice-Chair is Stephen O'Connor, the Chair of the International Swaps and Derivatives Association. The composition of the MPG seeks to achieve a balance among currencies, jurisdictions, types of financial intermediary and the buy-side and sell-side. The terms of reference for the group focus on two main areas:

    a. Proposing options for robust reference interest rates that could serve as potential alternatives to the most-widely used existing benchmark rates. The proposed rates should be consistent with the IOSCO Principles.

    b. Proposing strategies (testing, protocols, and timing) for any transition to new reference rates and for dealing with legacy contracts in the national or regional currency. This should include identifying problems that could arise in moving to new benchmark rates, and how these can be addressed.

The MPG has been asked to provide an interim report and draft recommendations to the OSSG by end-December 2013 and its final report to the OSSG by mid-March 2014.

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

The FSB published in August 2013 a progress report on reducing reliance on credit rating agency (CRA) ratings and strengthening oversight of CRAs.[54]

6.2.1 Reducing reliance on CRA ratings

The FSB issued in 2010 *Principles for Reducing Reliance on CRA Ratings* and is closely monitoring the implementation of the principles. The goal of the FSB's Principles is to end mechanistic reliance on CRA ratings by banks, institutional investors and other market

[53] See http://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf.

[54] See http://www.financialstabilityboard.org/publications/r_130829d.pdf

participants by reducing the "hard wiring" of CRA ratings in standards, laws and regulations and by providing incentives for firms to develop their own capacity for credit risk assessment and due diligence. As demonstrated during the financial crisis such reliance can be a cause of herding behaviour and of abrupt sell-offs of securities when they are downgraded ("cliff effects") which can in turn amplify procyclicality and cause systemic disruption.

The G20 Leaders in their 2012 Los Cabos Declaration called for accelerated progress by national authorities and SSBs in ending the mechanistic reliance on credit ratings. In response to this call, the FSB published a roadmap[55] in October 2012 with timelines to accelerate implementation of the FSB Principles.

Thematic peer review on reducing reliance on CRA ratings

The FSB is currently conducting a thematic peer review of progress made in member jurisdictions in implementing the Principles. The peer review's main objective is to assist national authorities in fulfilling their commitments under the roadmap. The review focuses on those aspects of the Principles that are directly addressed to the official sector. It is structured in two stages, the first of which has recently been completed. An interim report was published in August, which includes a structured stocktaking of references to CRA ratings in national authorities' laws and regulations and of actions taken and underway to reduce these references.[56]

The interim peer review notes that the US has moved furthest to remove the hard-wiring of CRA ratings from their rules and regulations, through the implementation of the Dodd-Frank Act, and the EU has also made significant progress through the adoption of the CRA III Regulation. Progress in most other jurisdictions has been slower. Going forward, market participants need to improve their own capacity to make their own credit assessments in order that they can safely reduce their reliance on CRA ratings. This presents challenges and will take time. Nevertheless, despite the challenges, authorities need to accelerate work to end market participants' mechanistic reliance.

FSB members have agreed under the roadmap to disclose action plans that identify and prioritise further areas for changes in laws and regulations. The second stage of the peer review, which will commence in September 2013, will analyse information provided through the structured stocktaking and action plans as well as other steps being taken by national authorities to reduce references to CRA ratings in legislation and regulation and to promote strengthened credit assessment capabilities. The analysis in the second stage will result in lessons of experience and guidance that national authorities will be able to use as they work towards meeting their remaining roadmap commitments. The FSB intends to issue the final peer review report in early 2014.

Work by SSBs to reduce reliance on CRAs

SSBs continue to work to reduce references to CRA ratings in international standards and to encourage reduced reliance on CRA ratings by authorities and financial institutions; the G20 has called for accelerated progress by SSBs.

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[55] See http://www.financialstabilityboard.org/publications/r_121105b.pdf.

[56] See http://www.financialstabilityboard.org/publications/r_130829e.pdf.

Among the various financial regulatory standards, the greatest existing use of CRA ratings is in the Basel capital and liquidity standards, and accordingly the BCBS is the SSB with the most substantial work programme to find ways to reduce such references. The BCBS published in December 2012 a consultative paper on revisions to the Basel securitisation framework, which seeks to address a number of shortcomings in the existing framework including mechanistic reliance on external ratings. The BCBS has set up a Task Force on Standardised Approaches, one of whose objectives is to seek to reduce or remove, where possible, the reliance on external ratings, including developing supplementary measures for risk classification and encouraging stronger supervisory practices to promote alternative measures for risk assessment. In considering potential alternatives to use of CRA ratings, the BCBS is taking account of the challenges that also exist with respect to reliance on banks' internal models, the large variations in risk-weights that cannot be explained by underlying risks, the potential procyclicality of market-based indicators and the need for sufficient reliable in-house capacity to assess credit risks. The BCBS will make proposals on reducing reliance within its standardised approach by mid-2014.

Earlier stocktakes by other standard setters (IAIS, IOSCO, OECD) have found relatively few references within their own standards that encourage reliance on CRA standards. In line with the roadmap, by end-2013 these standard-setters will provide guidance to their members on steps to further discourage reliance on CRA ratings, and will facilitate sharing of ideas and best practices amongst their membership.

6.2.2 Transparency and competition in the CRAs market

IOSCO provided to G20 Finance Ministers and Governors in April 2013 a report on improving transparency and competition among CRAs,[57] following which the G20 asked the FSB to examine the need for further work in the area of transparency and competition among CRAs, in the light of domestic and regional initiatives.

IOSCO's report covers its work to date to promote CRA transparency, the CRA transparency measures taken by IOSCO member jurisdictions, and IOSCO's ongoing work to further revise its Code of Conduct Fundamentals for CRAs (the initial revision of its original 2004 Code took place in 2008).

IOSCO noted that CRA transparency and competition are linked, in that transparency assists users of credit ratings in comparing the processes and performance of CRAs. IOSCO's stock-take shows that robust transparency requirements are a fundamental component of the CRA registration and oversight programs administered by IOSCO members, and that, especially post-crisis, IOSCO members have implemented laws and regulations that require CRAs to disclose information about rating methodologies, rating performance, conflicts of interest, and other operational matters.

With regard to competition, the historic dominance by three globally active CRAs that use the issuer-pays model continues. Smaller independent CRAs operate in some jurisdictions, and may focus on niche areas or on issuers not rated by the three largest CRAs, while others operate under the subscriber-pays model. Whether the smaller and new-entrant CRAs succeed in competing with the three largest CRAs in large part depends on convincing investors that

[57] IOSCO's April report to the G20 is available at http://www.iosco.org/library/briefing_notes/pdf/IOSCOBN01-13.pdf.

their credit ratings are of high quality, which, in turn, will incentivize issuers to hire them. This is where transparency can play an important role in market competition by allowing investors to compare the practices of CRAs.

IOSCO notes that its ongoing revision to the CRA Code, which will include reviewing and enhancing the IOSCO CRA Code's transparency provisions as appropriate, aims to update the Code so that it can operate in tandem with national CRA laws and regulations while it continues to operate as an international standard for self-governance. IOSCO aims to publish a draft of the revised IOSCO CRA Code for consultation in the first quarter of 2014 and the finalised IOSCO CRA Code by the third quarter of 2014.

6.3 Enhancing market functioning

Structural change in financial markets brought about by technological developments and the risks posed by financial innovation and ongoing globalisation necessitate continuous efforts to enhance the regulation and surveillance of market participants. In this regard, IOSCO published in March 2013 a consultation report on *Regulatory issues raised by changes in market structure*, which proposes possible policy options and regulatory tools to cope with the potential drawbacks arising from market fragmentation. It also published in May 2013 a report with recommendations to help market authorities address the *Technological Challenges to Effective Market Surveillance*.

The G20 committed at the Cannes Summit in 2011 to implement initial recommendations by IOSCO on market integrity and efficiency, including measures to address the risks posed by high frequency trading and dark liquidity. In their responses to the FSB's Implementation Monitoring Network (IMN) survey, only some FSB jurisdictions (e.g. Brazil, Canada, EU, Singapore) report that they have made progress in adopting the recommendations in IOSCO's October 2011 report on *Regulatory issues raised by the impact of technological changes on market integrity and efficiency*. However, it should be noted that practices like high frequency trading and dark pools are not present in all jurisdictions.

Over the past year, IOSCO also published guidance on the regulation of market participants or products, such as *Principles for Ongoing Disclosure for Asset-Backed Securities* in November 2012; *Suitability Requirements with respect to the Distribution of Complex Financial Products* in January 2013; *Principles for the Valuation of Collective Investment Schemes* in May 2013; and *Principles for the Regulation of Exchange Traded Funds* in June 2013. It also issued a consultation report on the *Regulation of Retail Structured Products* in April 2013.

At the Seoul Summit, the G20 Leaders reiterated their commitment to work in an internationally consistent and non-discriminatory manner to strengthen regulation and supervision of hedge funds. Several FSB jurisdictions report having an oversight framework that includes registration of hedge funds or their managers and enhanced disclosure of information to investors and regulators based on the high-level principles in IOSCO's June 2009 report on *Hedge Fund Oversight*. While implementation is reported to be lagging in some other jurisdictions, due consideration must be given to the relative presence and importance of hedge funds in them. A significant development in that respect will be the transposition into national law by EU member states (originally planned for 22 July 2013 but not yet complete in all member states) of the Directive on AIFMs (Alternative Investment

Fund Managers) that includes rules for the registration or authorisation of AIFMs, the on-going operation of their business and rules on transparency and supervision.

An important element of maintaining effective oversight when a fund is located in a different jurisdiction from the manager is to have mechanisms for cooperation and information sharing between relevant authorities. As regards the EU Directive on AIFMs, the European Securities and Markets Authority has, on behalf of all EU member state securities regulators and four other EEA jurisdictions, negotiated bilateral MoUs with non-EU authorities on supervisory cooperation and information sharing for the oversight of globally active fund managers, and reached agreement with several non-EU FSB jurisdictions (Australia, Brazil, Canada, Hong Kong, India, Japan, Mexico, Singapore, Switzerland, US). IOSCO has also carried out a hedge funds survey in the past and has noted legal limitations regarding data sharing; a second survey is currently underway.

At the Los Cabos Summit, the G20 Leaders reaffirmed their commitment to enhancing transparency and avoiding abuse in financial commodity markets, and called on IOSCO to report on the implementation of its recommendations on commodity derivatives markets. In response, IOSCO published in October 2012 the results of a survey[58] among its members regarding the implementation of its 2011 *Principles for the Regulation and Supervision of Commodity Derivatives Markets*. The survey showed that a majority of respondents were broadly compliant with these Principles; where commodity derivative markets existed and non-compliance had been observed, many of those market authorities had proposed initiatives aimed at achieving full compliance. IOSCO has used the survey to discuss approaches to assist market authorities in implementing these Principles. The responses by FSB jurisdictions to the IMN survey indicate that overall progress in this area appears to be lagging, in part due to delays and challenges in implementing overall OTC derivatives market reforms that affect commodity derivatives just as they do other asset classes. The G20, in its July 2013 meeting, has noted that it intends to continue to follow up very closely the proper implementation of the IOSCO principles for the regulation and supervision of commodity derivatives markets.

7. Improving accounting, disclosure and data quality

7.1 Enhancing and aligning accounting standards

The International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) are continuing with their work to develop high quality converged accounting standards to meet the objectives that were set at the London Summit in April 2009. They have made progress in a number of areas relevant to financial stability, notably as regards the improvement of standards for financial instruments. On classification and measurement of financial assets and liabilities, the two boards are working together to eliminate differences between their models, and expect to complete their deliberations by the end of 2013. However, the two key areas where convergence has yet to be achieved are loan loss impairment and insurance contracts.

[58] The IOSCO survey is available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD393.pdf.

On loan loss impairment, IASB and FASB, consistent with earlier FSB recommendations, are each seeking to develop an expected loss impairment standard 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 proposals of the two boards represent improvements on the existing incurred loss approach, but they report difficulties in achieving a converged standard and have developed different expected loss models.

The FASB has exposed for public comment an expected credit loss model whereby, at each reporting date, an entity would recognise an allowance for credit losses on financial assets equal to its current estimate of the total expected credit losses over the life of the assets. The IASB has exposed for public comment a 'three-stage' approach in which loans are allocated to three categories according to the level of impairment, with good loans having a provision of one year's expected losses; loans with evidence of credit deterioration having a full expected loss provisions; and impaired loans having full expected loss provisions and reduced interest income. The IASB model would therefore initially require only a portion of the lifetime expected credit losses to be recognised, with full lifetime expected losses being recognised when the credit quality of a financial asset deteriorates significantly. Under both sets of proposals the provisions for loan losses are based on the same information set of loss expectations and, for poorly performing loans, the provisioning would be the same under both proposals. The difference between the proposals is in the impairment accounting for performing loans.

It continues to be very important to have a globally applied standard on accounting for loan loss provisions, which recognises losses on portfolios earlier and more consistently. The FSB is continuing its engagement with the two standard-setters to seek ways to achieve a consensus on a high quality standard in this important area.

On insurance contracts, the goal is to eliminate inconsistencies and weaknesses in existing practice and to provide a single principles-based standard to account for all such contracts. While the boards are working together on the insurance contracts project, they have reached different decisions on several basic matters. For example, while both boards have agreed to measure the insurance liability using a current measure of the estimated cost to fulfil the obligation, the boards have reached different decisions on several aspects of the model, including the recognition of changes in estimate, the inclusion of a risk margin in the measurement of the liability and the treatment of acquisition costs.

The two boards published separate exposure drafts in June. The obstacles to finding a converged solution for the insurance contracts project are proving difficult to overcome. The different decisions reached by the boards result in part from different starting points. The International Financial Reporting Standards currently do not include accounting requirements for insurance contracts so the IASB needs a final standard, whereas the FASB is proposing amendments to its long-standing insurance model.

The G20 has called on the IASB and FASB to finalise by the end of 2013 their work on key outstanding projects for achieving convergence on a single set of high-quality accounting standards, and the boards will report on progress to the FSB in November 2013.

7.2 Enhancing financial institutions' disclosures

In March 2012, the FSB facilitated the formation of the private sector Enhanced Disclosures Task Force (EDTF) to (i) to 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 presented in annual reports for end-year 2012. The EDTF report, 'Enhancing the Risk Disclosures of Banks', was published in October 2012. [59] The report contains principles and recommendations for improved bank risk disclosures and leading disclosure practices that are designed to provide timely information useful to investors and other users and can contribute, over time, to improved market confidence in financial institutions. The FSB views the principles and recommendations as a valuable step to improve the quality of risk disclosures.

At the FSB's request, the EDTF has produced a progress report[60] on the level and quality of the implementation of the recommendations in their October 2012 report, based on a survey of major banks' 2012 annual reports. The progress report demonstrates that the recommendations are beginning to make a positive impact on the reporting practices of global banks. The banks' self-assessment is that they have implemented 50% of the EDTF recommendations in aggregate in 2012 disclosures, up from 34% in 2011, and that they expect to implement 72% of the recommendations within their 2013 disclosures. The investors and analysts within the EDTF undertook a further review of the disclosures and indicated a lower degree of implementation than banks' own self-assessment, particularly for recommendations where they expect more granular, quantitative disclosures. Banks, investors and analysts in the EDTF see the opportunity to engage over the coming year to further enhance risk disclosures for the 2013 reporting cycle.

Investors and analysts in the EDTF noted that the improvements in transparency and comparability of risk disclosures that are being seen as a result of implementation of the EDTF report are fostering greater confidence in banks' reporting by investors and other stakeholders. This both increases banks' ability to access capital when needed, and enhances market discipline. The FSB will ask the EDTF to undertake another survey in 2014 of the level and quality of implementation in the 2013 annual reports of major banks.

7.3 Building a global legal entity identifier

At the Cannes Summit in 2011, the G20 provided a mandate to the FSB to lead the co-ordination of international regulatory work and to deliver concrete recommendations for the appropriate governance framework for a global legal entity identifier (LEI) system, representing the public interest. The G20-endorsed FSB LEI report noted that the LEI system would provide a valuable 'building block' to contribute to and facilitate many financial stability objectives, including: improved risk management in firms; better assessment of micro and macroprudential risks; facilitation of orderly resolution; containing market abuse and curbing financial fraud; and enabling higher quality and accuracy of financial data overall. Following the provision of the FSB recommendations to G20 in June 2012 and their subsequent endorsement at the Los Cabos Summit, the FSB was further tasked to coordinate

[59] See http://www.financialstabilityboard.org/publications/r_121029.pdf.

[60] See http://www.financialstabilityboard.org/publications/r_130821a.pdf.

the implementation of the system and to prepare the Charter for the LEI Regulatory Oversight Committee (ROC). The G20 Finance Ministers and Central Bank Governors endorsed the Charter in November 2012, thus initiating the process for the ROC to be formed as the permanent governance body for the system. The ROC was established in January 2013 and took over full responsibility from the FSB at that time for the implementation of the global system, in accordance with the G20-endorsed FSB LEI High Level Principles and Recommendations. It currently has 55 member authorities from across the globe – an additional 19 authorities participate as observers.

As highlighted in progress notes published by the ROC,[61] a key next step is to establish the legal framework for the global LEI foundation that will act as the operational arm of the system, and thereby support on a not-for-profit basis the implementation of a global LEI in the form of a reference code to uniquely identify distinct entities that engage in financial transactions. The ROC has now agreed on all material issues relating to the development of statutes that will govern the foundation. These statutes have been delivered for review by the FSB in its role as the proposed founder of the global foundation and will allow the next steps in establishing the Central Operating Unit of the global system to be taken, including formation of the inaugural Board of Directors of the foundation.

The ROC has also made significant progress in establishing an interim system to provide globally acceptable "pre-LEIs" that can be used in the near term for regulatory reporting purposes. At its first plenary meeting in January, the ROC agreed to establish an interim "pre-LEI system" for global acceptance of "pre-LEIs" that meet global standards. Following the subsequent definition of these global standards, the ROC has agreed and published a process for ROC endorsement and global acceptance of pre-LEIs and pre-Local Operating Units (LOUs). The process for the endorsement of pre-LEIs requires submission by a sponsoring authority to the ROC of information that demonstrates that the pre-LOU meets a set of minimum global standards, followed by examination and endorsement by the ROC. Currently there are thirteen pre-LOUs that have been assigned prefixes to support the planning of pre-LOU services and to facilitate the issuance of pre-LEI codes. As of 26 August, four are operational – others are planning to start operations shortly.

The ROC has begun processing incoming requests from sponsors for global endorsement. First endorsement decisions are expected to occur shortly.

8. Building and implementing macroprudential frameworks and tools

The G20 Leaders at the Cannes Summit called for further development of macroprudential policy frameworks and tools to limit the build-up of risks in the financial sector. Since then, FSB jurisdictions continue to make progress in the establishment of regulatory frameworks for macroprudential oversight. A number of jurisdictions (Brazil, China, EU, France, Germany, Italy, Mexico, Turkey, UK, US) have established new committees/councils that have explicit mandates for assessing systemic risk and maintaining financial stability. For example, Germany formally established a Financial Stability Committee on 1 January 2013 that is in charge of macroprudential oversight. In addition, the ESRB issued recommendations

[61] See http://www.financialstabilityboard.org/list/fsb_pa/tid_156/index.htm.

in December 2012 on money market funds and the funding of credit institutions and in April 2013 on intermediate objectives and instruments of macroprudential policy in the EU. Other jurisdictions have also been enhancing the macroprudential framework within their existing institutional setup.

The FSB peer reviews of the UK and the USA examined the institutional arrangements for systemic oversight in those jurisdictions. Some of the main findings are as follows:

- UK – A new regulatory framework came into force in the UK on 1 April 2013, which included the establishment in statute of a macroprudential authority, the Financial Policy Committee (FPC) within the Bank of England, to monitor and take action to mitigate systemic risks. The FPC has the power to: (1) make 'comply or explain' recommendations to the new microprudential and conduct-of-business authorities (PRA and FCA); and (2) mandate that the PRA/FCA adopt certain macro-prudential tools (countercyclical capital buffer and sectoral capital requirements). Prior to its formal establishment, the interim FPC helped develop the framework for macroprudential policy in the UK and made a series of recommendations focused on creating a more adequately (and transparently) capitalised banking system. The peer review, to be published later this month, notes the need to manage execution risks and to fine-tune the framework as more experience is gained, and identifies issues that warrant further consideration to enhance the FPC's effectiveness and operations, including by strengthening its engagement with the FCA.[62]
- US – The Dodd-Frank Act addressed the systemic risk oversight gap in the regulatory framework by creating the FSOC and by making it directly accountable to the US Congress. To support the activities of the FSOC and its member agencies, the Dodd-Frank Act also created the Office of Financial Research (OFR) within the Treasury Department. The FSOC has facilitated coordination and the exchange of information by US member agencies so as to move towards a common approach to assessing and mitigating systemic risks. The FSOC has already designated eight FMIs and two non-bank financial companies as systemically important, and these institutions will be subject to enhanced regulation and supervision by the Federal Reserve Board. The Dodd-Frank Act did not, in general, alter the regulatory authorities and powers of the FSOC's member agencies when establishing the Council. Thus, the FSOC can make 'comply or explain' recommendations for heightened prudential regulatory standards in areas within the purview of a member agency, but can only impose them in limited situations. A notable action in that respect was the release by the FSOC in November 2012 of a proposed set of recommendations to the SEC on regulatory options for strengthening the regulation of MMFs. The peer review found that good progress has been made to date by the FSOC to establish systemic oversight arrangements and made some recommendations to further enhance its effectiveness.[63]

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[62] These involve the FPC's use of PRC/FCA technical expertise in identifying and implementing policies to promote financial stability; the enhancement of the FPC's relationship with the FCA and the FCA's capacity to undertake systemic risk analysis work; and further clarification of the FPC's involvement in the overall prudential framework.

[63] These involve the role of the FSOC in coordinating the work of its member agencies from a macroprudential perspective, including in systemic risk identification and analysis; the role of the OFR in supporting the FSOC's activities; and ways to enhance public communication. See http://www.financialstabilityboard.org/publications/r_130827.pdf for more details.

Work on macroprudential policy frameworks/tools and their interaction with other sets of policies is ongoing at the international level. The IMF has published a number of working papers and discussion notes on this topic over the past year, while the CGFS issued a report in December 2012 on operationalising the selection and application of macroprudential instruments.[64]

9. Strengthening adherence to international financial standards

The FSB, in collaboration with the SSBs, established a framework in October 2011 – the Coordination Framework for Implementation Monitoring (CFIM) – for monitoring and reporting on the implementation of the G20 financial reforms.[65] The framework, which was 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", 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 CFIM also highlights priority reform areas, to be reviewed and updated periodically, which will undergo more intensive monitoring and detailed reporting via implementation progress reports and peer reviews. The current list of priority areas agreed by the FSB comprises the Basel II/II.5/III framework; OTC derivatives market reforms; compensation practices; policy measures for G-SIFIs; resolution frameworks; and shadow banking. In those priority areas where policy development work is largely completed and implementation is already underway (Basel III; OTC derivatives; compensation practices; resolution frameworks), the FSB is working with relevant SSBs to ensure that the scope and approach of implementation monitoring are sufficiently comprehensive and rigorous as called for under the CFIM. Implementation monitoring will also be extended to the other priority areas where significant policy development work is still ongoing.

The FSB's IMN is tasked with collecting information from national authorities and reporting on the implementation of financial reforms in areas not designated as priority areas under the CFIM. The IMN also serves as the FSB's information collection "hub" and portal on overall national progress in implementing the G20/FSB recommendations on financial regulatory reform.[66] Over the course of the past year, the IMN has streamlined the information collection process on non-priority areas to facilitate its analysis and reporting to end users. In addition, to improve implementation dissemination efforts, the IMN has posted recommendation-wise and jurisdiction-wise snapshots of self-reported progress on the FSB website as a complement to individual survey responses.

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

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64 See http://www.bis.org/publ/cgfs48.pdf.

65 See http://www.financialstabilityboard.org/publications/r_111017.pdf.

66 See http://www.financialstabilityboard.org/activities/implementation_monitoring/index.htm.

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. Over the past year, the FSB has completed thematic peer reviews on risk governance (see section 2.4) and resolution regimes (see section 3.1) as well as the first stage of the review on reducing reliance on CRA ratings (see section 6.2). The FSB has also completed the country peer reviews of South Africa, UK (forthcoming) and the US. Two more peer reviews – Indonesia and Germany – are underway and will be completed by early 2014. All completed peer review reports are available on the FSB website.[67]

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*.[68] Importantly, all FSB jurisdictions with FSAPs older than five years – presently interpreted as completed in 2008 – have formally requested or are undergoing FSAP Updates, and almost all jurisdictions that completed their FSAP and sectoral compliance assessments have already published the results. In addition, several FSB jurisdictions (Canada, Hong Kong, Italy, Korea, Singapore) are currently undergoing an FSAP assessment.

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. Following the Los Cabos Summit, the FSB published in November 2012 the second Status Update on progress made by this initiative.[69] The report showed that since November 2011 (when the first such statement was published), three additional jurisdictions – China, Czech Republic and Saudi Arabia – had demonstrated sufficiently strong adherence to the relevant regulatory and supervisory standards in the areas of banking supervision, insurance supervision and securities regulation, thus taking the total number of adherent jurisdictions to 44 out of a total of 61 in the FSB's evaluation pool. Of the two jurisdictions that were listed in the November 2011 Public Statement as "non-cooperative jurisdictions", Venezuela continues to remain in that category while Libya was temporarily suspended from the evaluation process in view of the change of regime in that country. The remaining jurisdictions in the evaluation pool are yet to demonstrate sufficiently strong adherence to the relevant standards, and therefore remain under the FSB's evaluation.

10. Promoting long-term investment finance

At the meeting of the G20 Ministers and Governors in November 2012, the FSB was asked to undertake diagnostic work, together with other relevant international organisations (IOs), to assess factors affecting long-term (LT) investment financing. In February 2013, the FSB reported[70] to the G20 initial findings on the financial regulatory factors affecting the availability of LT investment finance as part of broader diagnostic work undertaken by IOs.

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

68 See http://www.financialstabilityboard.org/leading_by_example/index.htm.

69 See http://www.financialstabilityboard.org/publications/r_121102a.pdf.

70 See http://www.financialstabilityboard.org/publications/r_130216a.pdf.

Ministers and Governors welcomed the report by IOs and establish a new Study Group on Financing for Investment[71] to consider issues raised in the report. In addition, Ministers and Governors asked the FSB to "*continue to monitor the possible effects of regulatory reforms on the supply of long-term financing*" as one important component of this work.

To support the response to the request, the FSB organised a workshop[72] in June 2013 to identify specific financial regulatory factors that may be impeding the provision of LT finance and that may warrant a policy response at the international level, without compromising global financial stability objectives, and reported[73] its main findings to the G20 Study Group and to Ministers and Governors in September 2013.

As highlighted in the February FSB report, the most important contribution of financial regulation to LT investment finance is to promote a safe, sound and resilient financial system. If implemented in a timely and consistent manner, reforms to financial regulation will help rebuild confidence in the global financial system, which will enhance the intermediation of financial flows through the cycle and over different investment horizons. For this reason, the G20 regulatory reform programme is supportive of LT investment and economic growth.

The regulatory reforms do not specifically target LT finance. Nonetheless, they affect financial market structures and the incentives of different types of financial institutions to participate in different markets as well as the costs of different types of transactions. As the balance of incentives changes, and as banks are likely to play a lesser role than in the past, participants in the capital market and institutional investors which are the most natural providers of LT finance in the financial system will need to assume a greater role in the provision of LT finance.

The workshop provided feedback from market experts on recent developments in the provision of LT finance markets and on the influence of financial regulations. A number of potential pressure points in relation to the provision of LT finance were highlighted such as: some pullback and shortening of maturities of bank lending; the ability and willingness of institutional investors to provide additional long-duration finance given rising demand and less active involvement of the banking sector; the importance of additional transparency surrounding the performance of LT investments; and the development of the market for hedging of LT risks, which plays an important role in the structuring and overall viability of investment projects.

Since many of regulatory reforms are still at an early stage of implementation or remain in the process of policy development, it is too early to observe the effects of regulatory reforms on provision of LT finance. In addition, financial regulation is one of a number of influences that

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[71] The G20 Study Group on Financing for Investment has identified five core topics as the initial basis for its work: i) country-specific factors that can affect a country's ability to attract LT financing; ii) capital market developments including local currency bond markets; iii) private sources of financing including institutional investors; iv) official sources of financing including multilateral development banks; and v) implication of global financial regulatory reforms.

[72] The workshop brought together practitioners in LT finance from the private and official sector to join representatives from the FSB membership of national authorities, IOs and SSBs. Participants joined from a wide range of backgrounds from across the globe, including: finance providers (banks, insurance companies, pension funds and asset managers, infrastructure funds, sovereign wealth funds and multilateral development banks); finance users (commercial companies); project finance developers and facilitators (law firms, consulting and accountancy firms, credit rating agencies); and independent experts (academia).

[73] See http://www.financialstabilityboard.org/publications/r_130829g.pdf.

affects the incentives of providers to offer LT finance. It is difficult to distinguish the effects of stronger financial regulation from other influences such as the desire of finance providers to improve their internal risk management practices and to hold higher capital and liquidity buffers as a response to the lessons of the crisis.

The FSB has developed a monitoring framework for assessing the impact of these and other regulatory reforms[74], in part to help guard against material unintended consequences and impacts. The impact of financial regulation on the provision of LT finance for investment will be monitored under this framework to avoid duplication and to ensure continuity of monitoring. The FSB is working with relevant SSBs (BCBS, IOSCO, IAIS, IASB, OECD), FSB working groups, and other members (IMF, World Bank, European Commission) and will continue the engagement with practitioners in LT finance from the private and official sector to draw together information on the effects of regulatory reforms and to ensure that any relevant findings are evaluated by the FSB and reported to the G20.

11. Other issues

11.1 Effects of regulatory reforms on EMDEs

In June 2012, the FSB, in collaboration with the IMF and World Bank, published a study identifying the extent to which the internationally agreed regulatory reforms may have unintended consequences for emerging markets and developing economies (EMDEs).[75] The G20 Leaders, in the Los Cabos Summit Declaration, welcomed the study and "*encourage[d] continued monitoring analysis and reporting by the FSB and dialogue among the FSB, standard-setters, international financial institutions and national authorities of EMDEs, to address material unintended consequences as appropriate without prejudice to our commitment to implement the agreed reforms*".

The main findings from the FSB's monitoring over the past year are as follows:

- Most reforms identified by EMDEs as impacting them are the same as those described in the June 2012 FSB study – namely, the Basel III capital and liquidity frameworks; OTC derivatives market reforms; policy measures for G-SIFIs, including resolution regimes; and banking structural reform initiatives in Europe and in the US that go beyond internationally agreed financial regulatory reforms.
- EMDEs' concerns about potential unintended consequences of these reforms remain qualitative (rather than quantitative) in nature, reflecting the early stage of implementation. This confirms the need for ongoing long-term monitoring and the approach taken by the FSB to embed such monitoring, analysis and reporting into existing mechanisms and consultation channels where possible.
- The concerns of EMDEs concerning Basel III reforms continue to be driven by domestic implementation challenges and by the need for adequate home-host coordination to address potentially adverse cross-border effects. The focus of attention

[74] See http://www.financialstabilityboard.org/activities/implementation_monitoring/index.htm for details.

[75] See http://www.financialstabilityboard.org/publications/r_120619e.pdf.

has shifted towards liquidity ratios as it becomes increasingly clear that banks in many EMDEs will be able to meet the minimum capital requirements and as the details of the new liquidity standard become clearer.

- The diversity in the structure and characteristics of financial systems across EMDEs that are not members of the G20/FSB calls for flexibility in their approach to implementation of internationally agreed reforms. In particular, a number of these jurisdictions are adopting a phased approach that reflects their national policy priorities and capacity constraints. The international community should support this approach by sending a clear and consistent message on the appropriate pace of adoption of international financial standards in non-G20/FSB EMDEs .[76]
- A cross-cutting theme is the lack of adequate resources and expertise in EMDEs to adequately respond to the numerous post-crisis global regulatory initiatives. This finding reinforces the need for the international community to expand its efforts to assist EMDEs in developing capacity through targeted and well-coordinated technical assistance, training and knowledge sharing activities.
- IOs and SSBs are increasingly focusing on the implementation challenges of agreed reforms on EMDEs and have stepped up their monitoring, analysis and assistance.[77] Additional guidance by SSBs and the identification of good practices, where appropriate, would facilitate the application of new international standards in EMDEs.

In terms of next steps, the FSB will continue to monitor and report on the effects of agreed regulatory reforms on EMDEs as part of its overall implementation monitoring framework. An important objective of this monitoring will continue to be the sharing of implementation experiences and lessons across EMDEs and within the FSB. This can help foster a better understanding of the different impacts arising from the implementation of agreed reforms on EMDEs and thereby facilitate the mitigation of any material unintended consequences.

11.2 Strengthening deposit insurance

The International Association of Deposit Insurers (IADI) has prepared a number of guidance and research papers over the past year, including in response to the recommendations of the February 2012 FSB thematic peer review on deposit insurance systems (DIS).[78] A number of FSB jurisdictions (Australia, some EU member states, Mexico, Russia, Turkey) have recently amended, or are in the process of amending, their DIS to more closely align them with the

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[76] The October 2011 FSB-IMF-World Bank report on financial stability issues in EMDEs (http://www.financialstabilityboard.org/publications/r_111019.pdf) noted that "the more financially-integrated EMDEs—especially those that belong to the G20/FSB and participated in the development of this framework—should adopt the framework according to the agreed timetable. Other countries, with less internationally integrated financial systems and/or with substantial supervisory capacity constraints, should first focus on reforms to ensure compliance with the Basel Core Principles and only move to the more advanced [Basel] capital standards at a pace tailored to their circumstances".

[77] For example, the BCBS Basel Consultative Group (BCG) has established a work stream to identify the impact of Basel III implementation on emerging market and smaller economies. The BCG will update the BCBS later in 2013 on its work in identifying major unintended consequences and possible guidance on how to address practical issues associated with implementation.

[78] These cover deposit reimbursement systems and processes; public awareness; deposit insurance coverage; moral hazard and deposit insurance systems; ex-ante funding; and multiple deposit insurance systems. See http://www.financialstabilityboard.org/publications/r_120208.pdf.

June 2009 BCBS-IADI *Core Principles for Effective Deposit Insurance Systems*. China and South Africa indicate that they do not yet have an explicit DIS, while Saudi Arabia reports having a depositor protection framework that it considers to be an alternative arrangement to a DIS.

11.3 Enhancing consumer finance protection

In October 2011 the FSB published a report on consumer finance protection with a particular focus on credit,[79] which set out three recommendations to help advance consumer finance protection efforts. These recommendations are being implemented by the Financial Consumer Protection Network (FinCoNet). In August 2013, FinCoNet launched a survey on responsible lending that aims to collect information from jurisdictions on any consumer credit responsible lending obligations and related implementation arrangements. This effort builds on and intends to complement earlier global surveys and reports in this area. The work will provide an overview of initiatives around responsible lending obligations from around the world, focusing specifically on responsible lending through the broad consumer credit market, including both secured and unsecured lending. It will also have an emphasis on the practical implementation of any responsible lending obligations which is of particular interest to financial consumer protection authorities. The survey and consequent report will provide a platform for authorities to exchange views, experiences and best practice approaches to the issue of responsible lending.

The OECD is drafting a report on effective approaches to support the implementation of its *High-Level Principles on Financial Consumer Protection*, which it will submit to the G20 Summit. The report, which draws on information gathered by the G20/OECD Task Force on Financial Consumer Protection, focuses on three priority principles: disclosure and transparency; responsible business conduct of financial services providers and their authorised agents; and complaints handling and redress. The development of effective approaches for the remaining principles will facilitate their implementation. In that regard, a number of FSB jurisdictions (Australia, Canada, France, Italy, Saudi Arabia, Singapore) report that their existing framework for consumer protection is already in line with the principles. Other jurisdictions, including the EU, Korea, Russia, South Africa, Switzerland and Turkey, have embarked on legislative/regulatory initiatives to enhance consumer protection in order to align their frameworks more closely with these principles.

12. Strengthening FSB capacity, resources and governance

12.1 Strengthening FSB's capacity, resources and governance

At the Cannes Summit, G20 Leaders called for the FSB to be placed on an enduring organisational footing, with legal personality, strengthened governance, greater financial autonomy and enhanced capacity to coordinate the development and implementation of financial regulatory policies, while maintaining the strong links with the BIS. The FSB has

[79] See http://www.financialstabilityboard.org/publications/r_111026a.pdf.

since taken important steps to implement recommendations endorsed by G20 Leaders at the Los Cabos Summit in June 2012 to give effect to this request.

In January, the FSB was vested with legal personality by establishing itself as an association under Swiss law so as to place it on an enduring organisational footing.[80] The FSB will continue to be hosted by the BIS in Basel, Switzerland, and the two organisations have entered into an agreement which formalises the provision of financial and other resources for the FSB Secretariat through a five-year, renewable service agreement with the BIS so as to provide continuity and greater planning certainty to both parties. The FSB has established a Standing Committee on Budget and Resources to assess the resource needs of the Secretariat, and to review a medium-term budget and resource framework as well as annual resource budget.

New chairs of the FSB's three other Standing Committees were elected following the completion of the term of the previous incumbents, and a review of the composition of the membership of these three Committees has been conducted. The FSB has adopted procedural guidelines for its operational and administrative activities and practices. Following the St. Petersburg Summit, the FSB will set in train a review of the structure of its representation, which it envisages will be completed under the Australian Presidency of the G20.

12.2 Outreach through the FSB regional consultative groups

The FSB Regional Consultative Groups (RCGs)[81] established in 2011, bring together 65 FSB non-member jurisdictions and their counterparts in FSB member jurisdictions. Collectively, the RCGs have held 20 meetings since their inception, of which 11 were held since the Los Cabos Summit, to discuss a range of financial stability issues. Upon completion of the term of the inaugural co-chairs on 30 June 2013, most of the RCGs have appointed new co-chairs who will serve until 30 June 2015. Several RCGs have established working groups to study financial stability issues of interest to their region, with the RCGs presenting the results of the working group to the FSB Plenary as a part of the consultative feedback provided by non-FSB members.

[80] The FSB's Articles of Association are available at http://www.financialstabilityboard.org/publications/r_130128aoa.pdf.

[81] The six RCGs are for the Americas, Asia, the Commonwealth of Independent States, Europe, Middle East & North Africa, and Sub-Saharan Africa.

Annex: List of Abbreviations

AIFMs	Alternative Investment Fund Managers (EU Directive)
BCBS	Basel Committee on Banking Supervision
BCG	Basel Consultative Group (BCBS)
BIS	Bank for International Settlements
CCP	Central counterparty
CET1	Common Equity Tier 1 (capital adequacy ratio)
CFIM	Coordination Framework for Implementation Monitoring
CGFS	Committee on the Global Financial System
CMG	Cross-border Crisis Management Group
CPSS	Committee on Payment and Settlement Systems
CRA	Credit rating agency
CRD	Capital Requirements Directive (European Union)
DIS	Deposit insurance system
D-SIB	Domestic systemically important bank
EDTF	Enhanced Disclosures Task Force
EMDEs	Emerging markets and developing economies
EU	European Union
ESRB	European Systemic Risk Board
FASB	Financial Accounting Standards Board (US)
FinCoNet	Financial Consumer Protection Network
FMI	Financial market infrastructure
FPC	Financial Policy Committee (UK)
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
FSOC	Financial Stability Oversight Council (US)
GHOS	Group of Central Bank Governors and Heads of Supervision
GLAC	Gone-concern loss absorbing capacity
G-SIB	Global systemically important bank
G-SII	Global systemically important insurer
IADI	International Association of Deposit Insurers
IAIS	International Association of Insurance Supervisors
IASB	International Accounting Standards Board
IMF	International Monetary Fund
IMN	Implementation Monitoring Network
IO	International organisation
IOSCO	International Organization of Securities Commissions
LCR	Liquidity Coverage Ratio
LEI	Legal entity identifier
LOU	Local Operating Units (LEI)
LT	Long-term
MMFs	Money market funds
MPG	Market Participants Group
MRTs	Material risk takers
NAV	Net asset value

NBNI	Non-bank non-insurance (G-SIFIs)
NTNI	Non-traditional/non-insurance (activities)
OFR	Office of Financial Research (US)
OSSG	Official Sector Steering Group
OTC	Over-the-counter
P&S	FSB Principles & Implementation Standards for Sound Compensation Practices
RCAP	Regulatory Consistency Assessment Programme
RCG	Regional Consultative Group (FSB)
ROC	Regulatory Oversight Committee (LEI)
RWAs	Risk-weighted assets
SEC	Securities and Exchange Commission (US)
SIB	Systemically important bank
SIFI	Systemically important financial institution
SSB	Standard-setting body
TBTF	Too-big-to-fail
TR	Trade repository
UK	United Kingdom
US	United States