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FSB FINANCIAL STABILITY BOARD

As prepared for delivery

Diverse challenges, common threads: Preserving global financial stability today and tomorrow

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and

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Introduction

Good morning everyone,

I am delighted to be here, speaking in my capacity as Chair of the Financial Stability Board (FSB). The work of the FSB has benefitted from long-standing and constructive interactions with ISDA on a range of important areas. Two such examples of our collaborative efforts immediately spring to mind. First, thanks to the concerted effort undertaken by market participants and regulators, we have made huge progress in the transition to robust alternative reference rates across key global markets. Thirty LIBOR settings successfully ceased at the end of last year, and only five USD LIBOR settings remain in use. But, this work is not yet complete. In particular, it is essential that firms prepare for the cessation of the remaining USD LIBOR panels and that the new use of USD LIBOR is avoided.

A second area which has seen considerable progress since the global financial crisis, thanks to our combined efforts, is on over-the-counter (OTC) derivatives market reforms.[2] The vast majority of derivatives trades taking place in FSB member jurisdictions are now subject to requirements for trade reporting, central clearing, platform trading, and margining for non-centrally cleared derivatives.

We should draw a lot of inspiration from the success of these initiatives. Building on the lessons learnt, and the concerted action from various stakeholders, will help us to promote a resilient global financial system going forward. To this end, I would like to discuss current challenges that

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[1] The views expressed in these remarks are those of the speaker in his role as FSB Chair and do not necessarily reflect those of the FSB or its members.

[2] See, OTC Derivatives Market Reforms Implementation progress in 2021

we face in preserving financial stability. The biggest of these is Russia's invasion of Ukraine. But we are also facing structural challenges brought about by digital innovation and climate change. I will then reflect on some common threads arising from our initiatives to address these challenges. In short, our future work, like that which came before it, requires an emphasis on transparency, a holistic perspective and strong cooperation across sectors.

Current challenges: financial stability implications of Russia's invasion of Ukraine

Turning to current challenges, Russia's invasion of Ukraine has profoundly changed the global economic and financial market backdrop. The near-term growth outlook has deteriorated, challenging the prospects for a sustained and broad-based recovery from COVID-19. At the same time, inflation has returned, and with it the prospects of tighter global financing conditions.

The global financial system has absorbed the initial shock of the invasion without major adverse impacts on financial stability. Key funding markets have been functioning in an orderly manner. Notwithstanding bouts of high market volatility and large commodity price swings, no major financial institution has shown signs of distress. Market confidence has been buoyed by the recent experience of the pandemic, with the bold international policy response and the demonstrated resilience of the core of the global financial system, thanks to the G20's post-2008 crisis reforms.

Yet, global financial stability cannot be taken for granted. There is no room for complacency given the highly uncertain and rapidly evolving situation. Additionally, the past few weeks have surfaced a number of vulnerabilities that may crystallise in the face of further shocks.

The first relates to commodity markets. We have seen in March that very volatile commodity prices may give rise to financial strains – through large margin calls, leveraged positions and concentrated exposures. Such strains, by impairing the financing of the supply of key energy, base metal and food commodities, may have a disproportionately large macroeconomic impact. There may also be spill-over effects onto the broader financial system.

The second, related issue is undetected leverage. We have seen that certain banks, particularly prime brokers, seem to be prepared to take large positions without having sufficient visibility into the total leverage of their counterparties. I see similarities to the leverage taken on by Archegos prior to its collapse. This raises questions about transparency and the risk management capabilities of lenders. Such questions are particularly discomforting in an environment of high debt levels globally, and the prospect of tighter financing conditions.

Finally, there is cyber risk. Despite the apparent absence of a successful attack with systemic implications so far, we must not forget that cyber attacks remain a major vulnerability.

The FSB is responding to the current financial stability challenges in two main ways. We have stepped up our surveillance of market developments, with a focus on the resilience of critical nodes in the global financial system. The other response is through an in-depth analysis and assessment of specific potential vulnerabilities, with a particular focus on commodity markets, margining and leverage. On cyber risk, the FSB is working to promote greater convergence in cyber incident reporting, to support ongoing enhancements to cyber response and recovery capabilities among financial intermediaries.

Dealing with structural changes: climate-related financial risks and crypto assets

Russia's invasion of Ukraine has further highlighted the urgency of dealing with the financial implications of major structural shifts, namely climate change and digital innovation. As regards climate change, the war has triggered an intense debate around governments' current and future energy policies. This debate again reminds us of the reality of transition risk, and its relevance even over a relatively short time horizon.

To be effective in addressing the financial system risks associated with climate change, it is important to understand their full breadth and global nature. The FSB's Roadmap for Addressing Climate-related Financial Risks aims to achieve just that, by ensuring that these risks are incorporated into all financial decisions. The Roadmap also serves as a mechanism to support the coordination of the many initiatives at the international level in this area.

Our Roadmap covers four key topics: disclosures, data, vulnerabilities analysis, and regulatory and supervisory approaches. On disclosures, a key milestone was achieved with the recent publication of the International Sustainability Standards Board's draft climate and sustainability disclosure standards. These standards will provide a baseline level of transparency concerning firm-level exposures to climate-related risk. The FSB is supporting and monitoring the transition to these standards.

Increasing the availability of reliable financial data relating to key climate risks is essential for improving the assessment and management of these risks. To support this, the FSB and the Network for Greening the Financial System are working together on the use of scenario analyses by jurisdictions and the data needed for this analysis.

At the same time, current shortcomings in data should not prevent us from moving ahead with policy actions. It is better to act on incomplete data, than strive for perfection and act too late. In this spirit, the FSB recently published a report for public consultation on supervisory and regulatory approaches to addressing climate-related financial risks. This report aims to support consistent approaches across sectors and jurisdictions.

Turning to digital innovation, the Russia-Ukraine war has reinforced pre-existing concerns about the growth and potential illicit use of crypto-assets. In February, just a week before the invasion, the FSB provided the G20 with an updated assessment of the risks to financial stability posed by crypto-assets. Our report highlighted several vulnerabilities: First, important parts of crypto-asset ecosystems operate outside the regulatory perimeter. This makes the sector challenging to monitor and supervise. Second, interconnections between the traditionally regulated financial sector and the crypto sector are increasing. This may expose regulated markets to adverse spillovers. Third, crypto-assets pose challenges with regards to consumer and investor protection. A loss of confidence in crypto-asset markets could have system-wide implications through its effects on broader financial markets and the wealth of asset holders. Finally, there are the concerns about the use of crypto-assets in the context of money laundering, cyber-crime and ransomware.

The bottom line of our assessment is that crypto-asset markets are fast evolving and could soon represent a threat to global financial stability. The rapid evolution and international nature of these markets also raise the potential for regulatory gaps, fragmentation or arbitrage.

For these reasons, policy work on crypto assets is a priority for the FSB. We are taking forward work on the regulation and supervision of 'unbacked' crypto-assets and 'stablecoins'. The FSB is also analysing the financial stability impacts of rapidly developing Decentralised Finance (DeFi). Close collaboration with standard-setting bodies, including the Financial Action Task Force, is key.

It is also important to bear in mind that the crypto-asset markets of today are not operating in a lawless environment, or a barren regulatory landscape. Consequently, considering to what extent existing international standards address financial risks emanating from crypto-asset markets is an essential step. This will provide a basis for additional work to address risks not covered by these pre-existing standards. Thanks to its broad international and cross-sectoral membership, including the sectoral standard setters, the FSB is well placed to take a leading role in the design of a coherent global regulatory framework for crypto-assets.

Specific challenges, common threads

I have covered an array of topics, including commodity markets, leverage, climate change, and crypto-assets. While each of these raise specific challenges, they also reveal common threads in our efforts build an efficient, innovative and resilient global financial system. Let me elaborate on three of these common threads.

The first one is the importance of transparency. Sound data on risks provides the essential foundation to manage those risks. Concerns about the opacity of commodity markets, hidden leverage and the incomplete picture we have of crypto-asset markets underline the need to strengthen this foundation. An obvious step, even before considering the collection of new data is to check whether we are making the best use of the information that is already available. The Archegos case suggests that there may be quite a bit of homework do to. On climate, the challenge is to build on this foundation, by developing the data and metrics that link climate risks to financial exposures.

The second common thread revolves around looking at the financial system in a holistic manner. Many of the issues in commodity and crypto-asset markets are about the interconnection of these markets with the rest of the financial system. The importance of interconnectedness similarly came to the fore during the market turmoil in March 2020. Spill-overs between markets and non-bank entities were critical for the transmission and amplification of stress. The FSB's work programme for enhancing the resilience of non-bank financial intermediation (NBFI) shows how a holistic perspective can be developed. An initial step has been to identify and address vulnerabilities in specific areas of NBFI. We are now bringing together these various strands of work into a set of policies aimed at mitigating risk in the system as a whole. This is a key objective for 2022, the importance of which is further underscored by recent events.

The third common thread is the need for close cooperation between the private and the public sectors. None of the challenges that I talked about can be successfully addressed without such cooperation. Depending on the issue, this cooperation may take many different forms. At one end of the spectrum is the industry taking the lead on developing new tools, which may eventually become an international standard. The Taskforce on Climate Related Financial Disclosures, which is a partnership of private sector providers and users of disclosures, is a prime example. At the other end of the spectrum are public consultations on proposals developed through international cooperation among authorities. There are many possibilities in-between. The FSB's public outreach demonstrates our commitment to ensuring that the market perspective is heard. Continued engagement with ISDA is an important part of this outreach. We value your support, in completing the job on post-2008 global financial crisis reforms and on benchmark transition as well as on new issues, like the ones I have outlined today.

Conclusion

Let me conclude.

By embracing a holistic approach based on transparency and cooperation, we can continue to shape a financial system fit for the future. One that will harness the benefits of innovation and safely navigate the transition to net-zero. One where risks are properly measured and managed. One which is resilient to shocks, regardless of their origin.

The financial system is characterised by deep global integration and largely unfettered movements of capital. In this environment, international coordination and global financial stability go hand-in-hand. The FSB will continue to be a flagbearer for both.

Thank you.