To G20 Finance Ministers and Central Bank Governors

The financial stability outlook has become more challenging in recent weeks as a consequence of turmoil in the banking sector. In response, rapid and effective actions have been taken by authorities in Switzerland, the United States and other jurisdictions to maintain global financial stability. Alongside these developments, heightened volatility, reduced liquidity and large price swings emerged in key financial markets. The swift actions of authorities in individual jurisdictions have been complemented by the coordinated measures of central banks to enhance the availability of liquidity across borders.

Recent events have put to the test the G20’s financial reforms that followed the 2008 Global Financial Crisis. The global financial system is much better placed to absorb adverse shocks as a result of these reforms, which included considerable increases in the levels of bank capital and liquidity, an international framework for effectively resolving failing institutions, and strengthened cross-border regulatory and supervisory cooperation. Without these reforms, the stress faced by individual banks could have led to broader contagion within the financial system. But every test of financial resilience involves new challenges. Authorities must therefore remain vigilant to the evolving outlook. In the coming months, the FSB will carefully analyse recent events in order to learn from them.

The remainder of this letter discusses recent events in more detail and touches on the cyber incident reporting recommendations that the FSB will deliver to the upcoming G20 meeting.

Financial stability outlook

Events in the banking sector over the last month have been the latest in a sequence of shocks that have buffeted the global financial system in recent years. But, unlike most other recent shocks, this latest episode had its origins within the financial system. So the need for financial authorities to learn lessons, and act upon them, is all the greater.

In its ongoing surveillance, the FSB has been highlighting vulnerabilities associated with elevated debt levels, business models based on the presumption of low and stable interest rates, stretched asset valuations, and the combination of leverage and liquidity mismatches in non-bank financial intermediation (NBFI). Each of these vulnerabilities is sensitive to a tightening of financial conditions and a slowing of economic activity.

The reforms since the Global Financial Crisis have assisted in making the banking sector as a whole better able to absorb adverse shocks. Still individual institutions can fail, particularly when weaker business models and risk management capabilities are exposed, as they were recently by tighter financial conditions and liquidity challenges. These recent events highlight
that we cannot be complacent. The speed of developments in March, the precise nature of the vulnerabilities that crystallised and the associated market reactions provide important lessons for financial authorities, including for bank prudential and resolution frameworks. The FSB is working closely with the Basel Committee on Banking Supervision and other standard-setting bodies to comprehensively draw out these lessons and the consequent priorities for future work. At the same time, FSB members remain vigilant and stand ready to take policy measures to maintain the resilience of the global financial system.

The full, timely and consistent implementation of international financial standards remains key to bolstering global financial stability. During times like these, the role of the FSB in assessing global financial vulnerabilities and coordinating the development and implementation of international financial standards, and more generally as a conduit for information sharing and regulatory coordination, is crucial.

I would like to emphasise that while some reprioritisation of the FSB’s work programme may be necessary in response to recent events, we remain committed to delivering our previously agreed body of work to the G20, including in the areas of crypto-assets, NBFI, climate change and enhancing cross-border payments. These areas of work remain just as relevant as before, as they aim to address key vulnerabilities which could propagate or amplify future shocks to the global financial system.

Cyber resilience

The cyber threat landscape continues to expand amid digital transformation, increased dependencies on third-party service providers and geopolitical tensions. Addressing cyber risk requires timely and accurate information for effective incident response and recovery, and for promoting financial stability. Establishing a greater degree of convergence in cyber incident reporting amongst financial authorities will facilitate easier exchange of information at critical points and promote greater efficiency of cyber incident reporting requirements for globally active financial institutions. To support this goal, the FSB has submitted two reports to this meeting of the G20: recommendations to achieve greater convergence in cyber incident reporting; and a concept note for a format for incident reporting exchange (FIRE).

Conclusion

The recent challenges within the banking sector are a reminder that financial stability is not merely an abstract concept. It is essential for the smooth provision of credit, payment and other financial services to the real economy, and ultimately to sustained economic growth. In light of these developments, it is particularly important that we continue our collective efforts to preserve and enhance financial stability. The work of the FSB remains indispensable to that goal.

Working through its broad and diverse membership, the FSB will facilitate the monitoring of vulnerabilities across the global financial system, and the development of consensus based international standards to address these vulnerabilities. The FSB will also engage closely with the G20 in the months to come, to provide more details on the lessons learnt from recent events and their implications for its future work.
Yours sincerely,

Klaas Knot