FINANCIAL STABILITY BOARD

THE CHAIR

24 June 2019

To G20 Leaders

Ten years ago at the Pittsburgh Summit, the G20 Leaders gave the FSB the task of coordinating the post-crisis reforms to the financial system. Since then, with the continued support of the G20 Leaders, we have addressed the fault lines that surfaced during the crisis. Large banks hold more capital and liquidity, derivatives markets are more transparent, and securitizations are less complex.

We have made remarkable progress building a more resilient global financial system. Yet promoting global financial stability is a continuous task. We must remain vigilant to emerging risks. The episodes of higher macroeconomic and market volatility during the past year have reminded us that advanced and emerging market countries alike are subject to unexpected shifts in economic and financial conditions. At the same time, rapid technological change and aging populations require continued focus on promoting a sound and efficient financial system that fosters strong, sustainable, balanced, and inclusive growth.

Under the Japanese G20 Presidency, the FSB has continued to work to enhance global financial stability and to further the G20's goals. Specifically, over the last year the FSB has worked on:

- Addressing new and emerging vulnerabilities;
- Harnessing the benefits of financial innovation while containing risks;
- Completing implementation of the agreed reforms and ensuring that the reforms work as intended;
- Promoting an integrated global financial system; and
- Strengthening the FSB's outreach and accountability.

Addressing emerging vulnerabilities

Assessing vulnerabilities in the global financial system is at the core of the FSB's mandate, and we remain vigilant in identifying emerging risks. Potential vulnerabilities persist and, in some cases, have built up further.

Corporate and public debt levels have continued to rise. One particular issue is the extent to which financial institutions are exposed to riskier credit instruments, including leveraged loans, directly and through collateralized loan obligations (CLOs). While CLOs themselves appear to be stable holding structures for these assets, leveraged loan underwriting standards have loosened recently, and it is unclear where CLO exposures are distributed around the world, both among geographies and among types of institutions. The FSB is closely monitoring these markets and collecting information in order to obtain a fuller picture of the pattern of exposures to these assets globally.

Assessments of vulnerabilities also need to consider structural changes in the financial system. This includes the continued shift of financial intermediation to non-banks, which now account for almost half of global financial assets. The FSB continues to study the implications of these changes for financial stability and whether the existing set of policy tools are sufficient to address the resulting potential vulnerabilities.

To bring more rigor to the process of identifying vulnerabilities, the FSB will develop by next year a new surveillance framework. Drawing on the experience of the FSB's expert and diverse membership, the new framework will support comprehensive, methodical, and disciplined assessment of vulnerabilities.

The FSB also supports work to enhance private sector participation and transparency, including through risk disclosures. One example of this is the private-sector-led Task Force on Climate-related Financial Disclosures (TCFD). The TCFD has delivered to you its second status report on market take-up of its voluntary recommendations made in 2017. The increased participation levels by businesses confirm the value of these voluntary disclosures, allowing the public, markets, and investors to understand and better monitor and price risks. Nevertheless, as experience is gained, companies have further to go in improving practices in providing high-quality decision-useful material risk disclosures.

Harnessing the benefits of financial innovation while containing risks

Technological innovation in the financial sector offers potentially huge benefits, not least in terms of efficiency and inclusiveness. However, rapid progress can also present challenges. A deep and early understanding of how innovation may transform financial institutions and markets is key for harnessing benefits while containing risks. Furthering such understanding has been one focus of our work this year.

Among the reports we have presented to you is a study of the potential implications of new technologies leading to a decentralization of financial services. A reduction or elimination of the intermediaries and centralized processes that have traditionally been involved in the provision of financial services could benefit financial stability in some ways, and may also lead to greater competition and diversity in the financial system. At the same time, the growing use of such technologies could also entail various financial risks that need to be managed. Regulators may wish to engage in further dialogue with a wider group of stakeholders, including in the technology sector, that have had limited interaction with financial authorities to date.

One specific application of decentralized technology that is already creating opportunities, and raising challenges, is crypto-assets. We have provided you with a report on work underway on, and potential gaps in, regulatory and supervisory approaches to these rapidly developing assets. International organizations are working on a number of fronts to address issues, including consumer and investor protection, market integrity, anti-money laundering, countering the financing of terrorism, and understanding bank exposures to crypto-assets and potential risks to financial stability. Though crypto-assets do not currently pose a risk to global financial stability, gaps may occur where crypto-assets fall outside the scope of regulators' authority or from the absence of international standards. A wider use of new types of crypto-assets for retail payment purposes would warrant close scrutiny by authorities to ensure that that they are subject to high standards of regulation. The FSB and standard setting bodies will monitor risks very closely and in a coordinated fashion, and consider additional multilateral responses as needed.

Finally, the FSB has continued to work on enhancing the cyber resilience of financial institutions. Complementing our earlier work to promote common understanding through a Cyber Lexicon, we are now developing a toolkit of effective practices to assist financial institutions, supervisors, and other relevant authorities before, during, and after a cyber incident. We have delivered to you a progress report on this project.

Completing implementation of reforms and ensuring that they work as intended

Finalizing post-crisis reforms and monitoring their effective implementation remains a focus of FSB work. As implementation progresses, we can evaluate the effects of those reforms to ensure that we are achieving the intended gains in financial stability and that the reforms are not unnecessarily burdensome.

We have sent you our annual summary of the progress made by FSB member jurisdictions in implementing the reforms. The report notes that the new financial regulatory framework called for by the G20 is now largely in place, but implementation is not complete and remains uneven across reform areas. The color-coded overview table attached to this letter illustrates this. It is critical to maintain momentum and avoid complacency, in order to achieve the goal of greater resilience. To ensure timely and consistent application of the agreed-upon standards, the continued support of G20 Leaders is needed. We will deliver a fuller progress report on implementation and effects of reforms to the G20 in October 2019.

To ensure that the reforms are working as intended, we have embarked on a program of rigorous evaluations on the effects of implemented reforms. We have issued for public consultation our third evaluation on the effects of reforms, which looks at financing for small- and medium-sized enterprises (SMEs). The consultative report does not identify material and persistent negative effects on SME financing, and notes that any transitory costs should be set against the wider financial stability benefits that come from reducing the likelihood and severity of financial crises.

The FSB is now turning to a larger evaluation exercise to assess the effects of too-big-to-fail reforms. This important project will examine whether too-big-to-fail reforms are reducing the systemic and moral hazard risks associated with systemically important banks. The FSB's extensive outreach to stakeholders, including through a call for public feedback, industry workshops and the involvement of academic advisors, will be critical to the success of the evaluation.

Promoting an integrated global financial system

An open and resilient financial system, grounded in agreed international standards, is crucial to support sustainable growth. The Japanese G20 Presidency asked the FSB to explore issues around market fragmentation and to consider tools to address these challenges, where appropriate. The report that we submitted to you examines issues relating to the cross-border trading and clearing of over-the-counter derivatives, cross-border management of capital and liquidity, and international sharing of data and other information. It identified several areas where further work may help to strengthen mechanisms and approaches to address market fragmentation through more efficient and effective cooperation going forward. This includes mechanisms to avoid future fragmentation.

In promoting an integrated system of cross-border payments, one specific area of concern for integrated cross-border flows is remittance service providers' access to banking services. The continuing decline in correspondent banking relationships, despite progress in implementing the FSB's four-point action plan, has had a significant impact on remittance service providers' access to banking services, particularly in developing countries where remittance flows are a key source of funds for households. We have submitted to you a report on the implementation of the March 2018 recommendations to improve such access. This issue remains a matter of concern, deserving continued G20 attention.

A concrete step to promote integrated markets is the introduction of the global Legal Entity Identifier (LEI). The regulatory uses of the LEI are multiple and the benefits can be substantial. Initiated with your support following the financial crisis to uniquely identify firms that engage in financial transactions, 1.4 million entities are now identified by an LEI in more than 200 countries. Notwithstanding this progress, the LEI has far to go to meet the G20's objective of truly global LEI adoption and the FSB has published recommendations to deliver on this fundamental post-crisis reform.

Strengthening outreach and accountability

Financial stability risks transcend the G20 and are broadly global in nature. Reaching out beyond its membership is therefore key for the FSB to achieve its mandate of promoting global financial stability. To strengthen the FSB's outreach to non-member countries, the FSB is conducting a review of the effectiveness of the FSB's six regional consultative groups, which are important networks for exchanging information and views on financial stability issues. I look forward to further enhancements in their contribution to our work.

The FSB is also committed to improve communication and transparency with other external stakeholders, to facilitate wider input to the FSB's work and increase understanding of what it does. The FSB is taking a number of steps to this end: standardizing its public consultation process; improving accessibility of information provided to the general public, including through the publication of its annual work program; and adopting a structured approach towards stakeholder involvement in individual FSB initiatives.

Conclusion

I would like to thank the Japanese G20 Presidency for its leadership and guidance this year. The FSB deliverables align with the G20 Presidency's priorities and demonstrate our refocused mission, including increased attention to new vulnerabilities, including in areas where technological innovations are playing an increasing role in financial services and are bringing new challenges to the global regulatory community.

The FSB's transition, from determined crisis response to the evaluation of the effects of post-crisis reforms as well as the rigorous assessment of emerging vulnerabilities and addressing them where needed, is therefore underway. The success of the next chapter of the FSB must be written with the help of all G20 members, with contributions from a wide array of stakeholders, including the knowledge of the private sector, the expertise of the academic community, and with input from the public—to whom we owe a resilient, equitable and inclusive financial system.

The success in building a safer and more resilient financial system over the last decade reflects the collaborative efforts of the G20. To deliver the more effective and efficient financial system in an age of rapid economic and technological change, this international cooperative spirit must continue. I therefore ask for G20 Leaders' continued support, both to complete implementation of the agreed reforms, and to cooperate to identify and, where identified, address new vulnerabilities.

Yours sincerely,

Randal K. Quarles

<u>Attachment</u>

Implementation of reforms in priority areas by FSB jurisdictions (as of June 2019)

The table provides a snapshot of the status of implementation progress by FSB jurisdiction across priority reform areas, based on information collected by FSB and standard-setting bodies' (SSBs) monitoring mechanisms. The colours and symbols in the table indicate the timeliness of implementation. For Basel III, the letters indicate the extent to which implementation is consistent with the international standard. For trade reporting, the letters indicate to what extent effectiveness is hampered by identified obstacles.

	Basel III^						**Compen-sation**	**Over-the-counter (OTC) derivatives**				**Resolution**				**Non-bank financial intermediation**	
Reform Area	Risk-based capital	Liquidity Coverage Ratio (LCR)	Require-ments for SIBs	Large exposu-res frame-work	Levera-ge ratio	Net Stable Funding Ratio (NSFR)		Trade reporting	Central clearing	Platform trading	Margin	Minimum external TLAC require-ment for G-SIBs	Transfer / bail-in / tempora-ry stay powers for banks	Recovery and resolution planning for systemic banks	Transfer / bridge / run-off powers for insurers	Money market funds (MMFs)	Securi-tisation
Agreed phase-in (completed) date	*2013 (2019)*	*2015 (2019)*	*2016 (2019)*	*2019*	*2018*	*2018*		*end-2012*	*end-2012*	*end-2012*	*2016 (2020)*	*2019/2025 (2022/2028)*					
Argentina	C	C					△										**
Australia	C	C			&											*	
Brazil	C	C		C		C	△										**
Canada	C	C														**	
China	C, △	C	C, &				△	R, F									
France	MNC	LC	C														*
Germany	MNC	LC	C														
Hong Kong	C	C														**	
India	C	LC															
Indonesia	LC	C														**	
Italy	MNC	LC	C														*
Japan	C	C	C														
Korea	LC	C														**	
Mexico	C	C						R								**	*
Netherlands	MNC	LC	C														*
Russia	C	C					△									**	
Saudi Arabia	C	LC		C		C		R								**	
Singapore	C	C														**	
South Africa	C	C					△									**	
Spain	MNC	LC	C														*
Switzerland	C	C	C													**	
Turkey	C	C														**	
United Kingdom	MNC	LC	C														*
United States	LC	C	C, &				△										

Legend

	• **Basel III:** Final rule published and implemented. Risk-based capital and leverage ratio are based on the initial reform package agreed in 2010 prior to Basel III finalisation in December 2017. Requirements for SIBs – covering both D-SIBs and higher loss-absorbency for G-SIBs (for G-SIB home jurisdictions) – published and in force. • **OTC derivatives:** Legislative framework in force and standards/criteria/requirements (as applicable) in force for over 90% of relevant transactions. • **Resolution:** Final rule for external Total Loss Absorbing Capacity (TLAC) requirement for G-SIBs published and implemented. For the powers columns, all three of the resolution powers for banks (transfer, bail-in of unsecured and uninsured credit claims, and temporary stay) and insurers (transfer, bridge and run-off) are available. Both recovery and resolution planning processes are in place for systemic banks. • **Compensation:** All FSB Principles and their Implementation Standards for Sound Compensation Practices (Principles and Standards) implemented for significant banks. • **Non-bank financial intermediation (NBFI):** MMFs – Final implementation measures in force for valuation, liquidity management and (where applicable) stable net asset value (NAV). Securitisation – Final adoption measures taken (and where relevant in force) for an incentive alignment regime and disclosing requirements.
△	• **Basel III:** Final risk-based capital rule implemented, with the exception of countercyclical capital buffer rule. • **Compensation:** All except a few (three or less) FSB Principles and Standards implemented.
	• **Basel III:** Final rule published but not implemented, or draft regulation published. • **OTC derivatives:** Regulatory framework being implemented. • **Resolution:** Final rule for external TLAC requirement for G-SIBs published but not yet implemented, or draft rule published. For the powers columns, one or two of the resolution powers for banks (transfer, bail-in of unsecured and uninsured credit claims, and temporary stay) and insurers (transfer, bridge and run-off) are available. Recovery planning is in place for systemic banks, but resolution planning processes are not. • **Compensation:** FSB Principles and Standards partly implemented (more than three Principles and/or Standards have not yet been implemented) for significant banks. • **NBFI:** MMFs – Draft/final implementation measures published or partly in force for valuation, liquidity management and (where applicable) stable NAV. Securitisation – Draft/final adoption measures published or partly in force for implementing an incentive alignment regime and disclosing requirements.
	• **Basel III**: Draft regulation not published. • **Resolution**: Draft rule for external TLAC requirement for G-SIBs not published. For the powers columns, none of the three resolution powers for banks (transfer, bail-in of unsecured and uninsured credit claims, and temporary stay) and insurers (transfer, bridge and run-off) are available. Neither recovery nor resolution planning processes are in place for systemic banks. • **NBFI**: MMFs – Draft implementation measures not published for valuation, liquidity management and (where applicable) stable NAV. Securitisation – Draft adoption measures not published for implementing an incentive alignment regime and disclosing requirements.
	• **Resolution**: Minimum TLAC requirements not applicable for jurisdictions that are not home to G-SIBs or to a subsidiary of a G-SIB that is a resolution entity under a multiple point of entry resolution strategy.
C / LC / MNC / NC	• **Basel III**: Regulatory Consistency Assessment Program (RCAP) – assessed "compliant" (C), "largely compliant" (LC), "materially non-compliant" (MNC) and "non-compliant" (NC) with Basel III rules. See the RCAP scale. The grade for SIB requirements relates only to the G-SIB requirements.
^	• **Basel III**: Does not include reforms finalised in December 2017, which take effect from 2022. Risk-based capital column excludes certain technical standards that came into force in 2017. Leverage ratio column based on the 2014 exposure definition.
&	• **Basel III**: Australia's implementation status on the leverage ratio is based on the revised (2017) exposure definition. China's G-SIB requirements are in force, while its D-SIB policy framework is under development. The US does not identify any additional D-SIBs beyond those designated as G-SIBs; its framework was found to be broadly aligned with the D-SIB principles. See the RCAP assessment (June 2016).