

COVID-19, the FSB and the G20 reform agenda

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Remarks by Dietrich Domanski, Secretary General, Financial Stability Board

Thank you, Nicolas, for inviting me, and for selecting the Financial Stability Board and the G20 reform agenda as a topic for a ‘Financial Statement’. The views that I am expressing at today’s session are mine and do not necessarily reflect those of the FSB or its members.

FSB FINANCIAL STABILITY BOARD **COVID-19 and the FSB’s work**

- COVID-19 represents the biggest test of the post-crisis financial system to date
 - Operational risk
 - Liquidity risk
 - Solvency risk

- COVID-19 related work priorities
 - Assessing financial stability risks and vulnerabilities
 - Informing policy discussions
 - Coordinating policy responses

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COVID-19 represents the biggest test of the post-crisis financial system to date. The pandemic constitutes an unprecedented global macro-economic shock, pushing the global economy into a recession of uncertain magnitude and duration.

This exogenous shock has placed the financial system under strain, along three main dimensions of risk.

- The first is operational risk. Precautionary lock down measures have tested contingency plans of financial institutions, and remote working may have challenged the execution of complex market operations and centralised functions.

- The second is liquidity risk. In March, downward revisions of expected economic activity and heightened risk aversion led to a major re-pricing and re-positioning in global financial markets, putting pressure on market liquidity. The preference for cash and near-cash assets led to a massive increase in the demand for funding liquidity.
- The third is credit risk. Corporate credit quality is deteriorating on a broad basis. Unlike in previous downturns, services and manufacturing sectors have been hit simultaneously, and there are pre-existing vulnerabilities in the form of high debt. At the same time, the demand for credit is expected to rise.

Against this backdrop, the FSB has re-prioritised its work programme, to provide effective support to our members (and stakeholders more generally) in their response to COVID-19.

The FSB is supporting international cooperation and coordination on the COVID-19 response in three ways: (i) assessments of financial stability risks and vulnerabilities that may lie ahead as the impact of COVID-19 on the global economy unfolds; (ii) work to inform policy discussions; and (iii) Third, we are working with our membership to coordinate on global policy responses. I'll come back to these activities in more detail later.



G20 core financial reforms

- **Making financial institutions more resilient**
 - Basel III
- **Ending 'too-big-to-fail'**
 - Higher capital and loss absorption capacity, more intensive supervision, and resolution frameworks for systemically important financial institutions
- **Making OTC derivatives markets safer**
 - Central clearing, trade reporting, platform trading, margin requirements for non-centrally cleared derivatives
- **Enhancing resilience of non-bank financial intermediation**
 - Money market funds, securitisation, securities financing

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One main question for today's meeting is what COVID-19 means for the G20 reform agenda. Before turning to this question, it may be useful to recall the main elements of the G20 reforms agreed after the 2008 financial crisis that have been coordinated by the FSB.

Slide 3 shows the four main reform areas, and key reforms undertaken in each area:

- First, making financial institutions more resilient, with Basel III at the heart of reform efforts.
- Second, ending ‘too-big-to-fail’. This reform area includes higher capital and loss absorption capacity, more intensive supervision, and, importantly, resolution frameworks for systemically important financial institutions
- Third, making OTC derivatives markets safer has involved the central clearing, trade reporting, platform trading, and margin requirements for non-centrally cleared derivatives
- And fourth, enhancing resilience of non-bank financial intermediation. The relevant reform areas include money market funds, securitisation, securities financing

Considering the breadth of this reform agenda, it is fair to say that the G20 reforms have profoundly changed the global financial system.

FSB FINANCIAL STABILITY BOARD **COVID-19 as test for the G20 reforms**

- **G20 reforms have increased financial system resilience**
 - Greater resilience of major banks at the core of the financial system
 - Those forms of market based finance that contributed to the 2008 financial crisis pose significantly lower financial stability risks
 - Financial market infrastructures, particularly CCPs, have functioned well
- **Challenge: sustain flow of credit amidst growing solvency risks**

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Bearing this in mind, COVID-19 is as much a test for the G20 reforms as it is for the financial system.

Overall, the global financial system has proven more resilient and better placed to sustain financing to the real economy, as a result of the G20 regulatory reforms in the aftermath of the 2008 global financial crisis.

- First and foremost, greater resilience of major banks at the core of the financial system has allowed the system to date largely to absorb rather than amplify the current macroeconomic shock.

- Financial market infrastructures, particularly central counterparties, have functioned well, despite the challenging external financial and operational conditions.
- And those forms of market-based finance that contributed to the 2008 financial crisis pose significantly lower financial stability risks.

Nevertheless, given the unprecedented scale of the shock, key funding markets experienced acute stress authorities needed to take a wide range of measures to sustain the supply of credit to the real economy and support financial intermediation. The policy actions taken have been bold, including large-scale central bank support that was required to improve liquidity in markets.

It is obviously too early to draw definitive conclusions. The pandemic is still unfolding, and the scale and duration of its economic impact persists. The financial system faces the dual challenge of sustaining the flow of credit amidst a global recession and of managing growing solvency risks.

Policymakers need to ensure that the financial system can continue to provide financing to the real economy under different recovery scenarios. Financial stability is a necessary condition for that.



Policy responses

- **Rapid and coordinated response**
 - to support the real economy
 - to maintain financial stability
 - to minimise the risk of market fragmentation
- **Authorities and standard setting bodies have**
 - encouraged the use of capital and liquidity buffers
 - provided guidance on the application of accounting rules
 - provided flexibility in the application of prudential requirements

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Turning to the policy response, authorities in G20 and FSB jurisdictions have taken a wide range of measures to sustain the supply of credit to the real economy, support financial intermediation, and preserve the resilience of the global financial system.

The policy measures taken have buttressed resilience of critical nodes in the financial system, including: (i) through direct fiscal support and government guarantee schemes to incentivise lending; (ii) through measures to alleviate US dollar funding shortages through central bank swap and repo arrangements; (iii) through measures to alleviate funding constraints from the shift of investors to safe assets; (iv) and through measures to support market functioning and ensure market integrity.

As funding market strains have abated, the focus has shifted to addressing a growing need for real economy financing amidst rising solvency risks. Authorities and standard setting bodies have:

- encouraged the use of capital and liquidity buffers to support the economy
- provided guidance on the application of accounting rules
- provided flexibility in the application of prudential requirements

At the risk of stating the obvious: many of these measures, first and foremost the use of buffers, have been made possible by the reforms implemented and the resilience built since the 2008 global financial crisis.

**Coordination**

- **FSB principles endorsed by the G20**
 - to monitor and share information on a timely basis to assess and address financial stability risks from COVID-19
 - recognise and use the flexibility built into existing financial standards to support our response
 - seek opportunities to temporarily reduce operational burdens on firms and authorities
 - act consistently with international standards, and not roll back reforms or compromise the underlying objectives of existing international standards
 - and coordinate on the future timely unwinding of the temporary measures taken

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Internationally coordinated action to support a well-functioning, resilient financial system and open markets remains a priority. Policy responses have been tailored to jurisdiction-specific needs. But they have been underpinned by common principles that authorities have agreed to

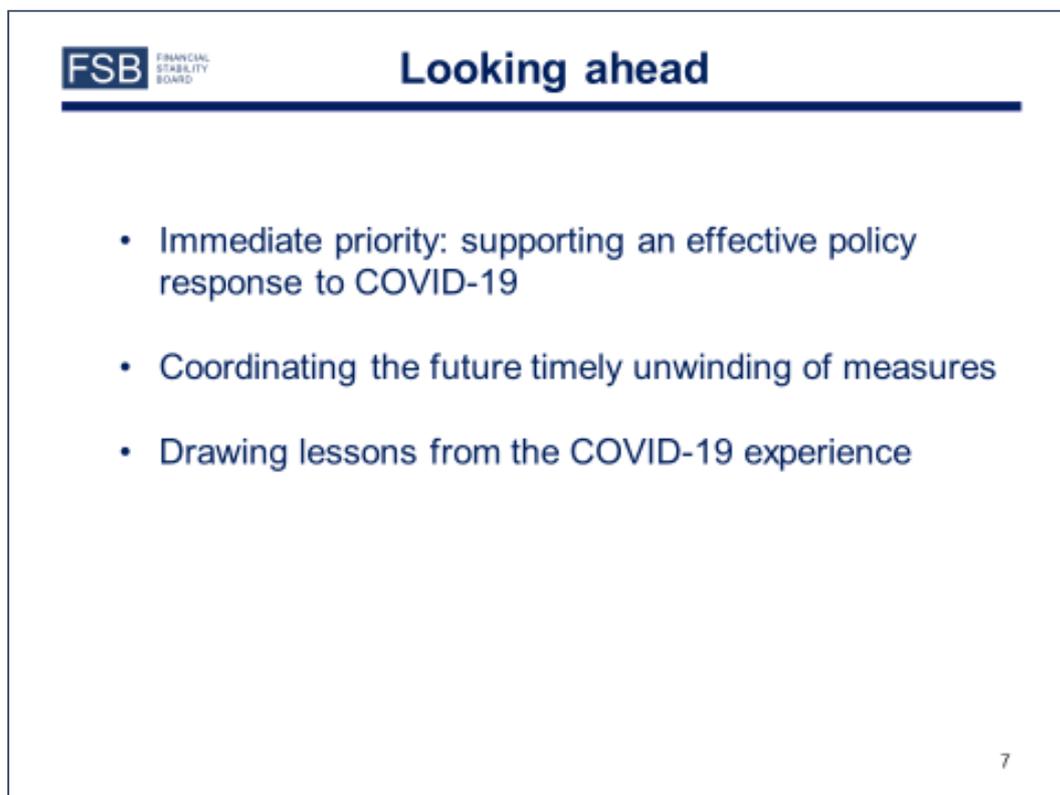
follow in future, to support the real economy, maintain financial stability and minimise the risk of market fragmentation.

Under these principles, authorities will:

- monitor and share information on a timely basis to assess and address financial stability risks from COVID-19;
- recognise and use the flexibility built into existing financial standards to support the response;
- seek opportunities to temporarily reduce operational burdens on firms and authorities;
- act consistently with international standards, and not roll back reforms or compromise the underlying objectives of existing international standards; and
- coordinate on the future timely unwinding of the temporary measures taken.

The G20 Finance Ministers and Central Bank Governors endorsed these principles in the April communique.

The FSB, working with the standard-setting bodies, is monitoring the use of flexibility and consistency of jurisdictions' COVID-19 policy responses with international standards. We will report on these to G20 Finance Ministers and Central Bank Governors at their virtual meeting in mid-July.



The image shows a slide from the Financial Stability Board (FSB) titled "Looking ahead". The slide features the FSB logo in the top left corner, which consists of the letters "FSB" in a blue box next to the text "FINANCIAL STABILITY BOARD". The title "Looking ahead" is centered at the top in a large, bold, blue font. Below the title is a thick blue horizontal line. Underneath the line, there are three bullet points in blue text: "• Immediate priority: supporting an effective policy response to COVID-19", "• Coordinating the future timely unwinding of measures", and "• Drawing lessons from the COVID-19 experience". In the bottom right corner of the slide, there is a small number "7".

What lies ahead, for the FSB in light of COVID-19?

The immediate priority is to support the international policy response to COVID-19. Addressing the financial stability risks from COVID-19, and supporting an effective policy

response will be the FSB's primary focus for the foreseeable future. I already mentioned that the FSB's work programme has been significantly reworked compared to the version we published in January. You can find further information on this on our website.

In due course, the question of the unwinding of policy measures will arise. As stated in the FSB principles, this future unwinding should happen in a coordinated manner, to avoid unintended spill-overs across financial sectors and jurisdictions, and to avoid harmful market fragmentation.

And then there may well be lessons for global financial and stability financial regulation to draw from the COVID-19 experience. What these lessons will be, we don't know, and we need to be careful not to jump to any conclusions. So all I would like to do in concluding is to offer three personal observations.

- The first is that we are seeing macroprudential policy in action. We are learning a lot about what is working and what may not (or not as intended), including about the role of buffers through the financial cycle – when to build them, when to release them and how to release them.
- The second observation concerns the question whether, and how, structural changes in the financial sector have affected financial stability. The growth of non-bank financial intermediation over the past decade is a case in point. This growth has added welcome diversity in the provision of finance. At the same time, the impact of COVID-19 on credit markets and some types of investment funds has highlighted potential vulnerabilities in this increasingly important sector and the need to understand the risks and the resulting policy implications.
- My third observation is on the role of the FSB going forward. COVID-19 has shown (again) that financial stability policy requires a holistic view of the global financial system. Bank and non-bank credit are closely interlinked; households may shift savings swiftly from money market funds to banks, and between emerging market and advanced economies. The FSB with its broad membership – central banks, bank and market regulators and ministries of finance from advanced and emerging market economies, international standard setters, and international organisations – this broad membership puts the FSB in the unique position to take the holistic perspective needed for financial stability policy.

Implementation of reforms in priority areas by FSB jurisdictions (as of September 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' (SSB) 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.

Reform Area	Basel III*						Compen- sation	Over-the-counter (OTC) derivatives				Resolution			Systemic Risk Financial Intermediation	
	Basel report 2013	2015 COVARI Ratio SJR	Require- ments for SIBs 2016 GSA 9	Large expos- ure frame- work 2019	Lever- age ratio 2018	Net Stable Funding Ratio (NSFR) 2018		Trade reporting	Central clearing	Portfolio trading	Margin	Minimum required TLAC require- ment for G- SIBs	Transfer/ sell-off/ temporary powers for banks	Recovery and resolution planning for systemic banks	Transfer/ sell-off/ powers for insurers	Money market funds (MMFs)
Agreed phase-in (imposed date)	2013 (2014)	2015 (2016)	2016 (2017)	2019	2018	2018	end-2017	end-2017	end-2017	2018 (2018)	2018/2017 (2018/2018)					
Argentina	C	C					Δ									**
Australia	C	C		C	A	C										**
Brazil	C	C		C		Δ										**
Canada	C	C		C		C										**
China	C, Δ	C	C, A				Δ	R, F								
France	MEN	LC	C													*
Germany	MEN	LC	C													*
Hong Kong	C	C														**
India	C	LC		C		C										*
Indonesia	LC	C														**
Italy	MEN	LC	C													*
Japan	C	C	C													*
Korea	LC	C														**
Mexico	C	C						R								**
Netherlands	MEN	LC	C													*
Norfolk	C	C					Δ									**
Saudi Arabia	C	LC		C		C		R								**
Singapore	C	C														**
South Africa	C	C					Δ									**
Spain	MEN	LC	C													*
Switzerland	C	C	C													**
Turkey	C	C														**
United Kingdom	MEN	LC	C													*
United States	LC	C	C, A				Δ									*