

To G20 Leaders

Progress of Financial Regulatory Reforms

The FSB and its members have continued to make good progress on the broad program of financial reforms started at the Washington Summit. The Cannes Summit marks delivery of internationally agreed policy measures to markedly reduce the risks posed by systemically important financial institutions (SIFIs). These include polices to address distress and failure at such firms without disruption to the financial system and without taxpayer support. These are essential reforms to foster a more disciplined and appropriately incentivized financial system.

We have also made progress this year to ready implementation of the Basel III standards, advance reform of derivatives markets, implement reforms of compensation practices, and to prepare more effective oversight and regulation of shadow banking system.

However, we have a long way to go to fully and consistently implement the reforms we have committed to and the policy measures already agreed. Your continued strong determination to see through the necessary changes in laws, regulations and supervisory practices remains essential to reduce systemic risks globally.

Last year you asked the FSB to bring forward proposals for strengthening its capacity, governance and resources so that it can fulfil its mandate and meet growing demands. I have reported to finance ministers and central bank governors on the progress made and set out at the end of this letter further steps for your consideration.

Addressing the risks posed by SIFIs

At the Seoul Summit you endorsed the FSB's framework to address the systemic and moral hazard risks associated with SIFIs. We have now completed the critical policy measures to implement this framework and agreed the timelines and processes for putting them into effect.

These key measures include:

- A new international standard - *The Key Attributes of Effective Resolution Regimes for Financial Institutions* - as a point of reference for consistent reform of national resolution regimes so that any financial institution can be resolved without disruptions to the financial system and without exposing the taxpayer to the risk of loss.
- Mandatory resolvability assessment and a recovery and resolution plan for each global SIFI, as well as a cross-border cooperation agreement between relevant authorities.

- Requirements for globally systemically important banks to hold additional common equity capital above the Basel III minimum standards, rising from 1% to 2.5% of risk-weighted assets commensurate with the systemic impact of their failure, to be fully phased in by 2019.
- More intensive and effective supervision, including through stronger mandates, resources and powers, and higher supervisory expectations for firms' risk management and data aggregation capabilities.

We have identified an initial group of 29 G-SIFIs to which the resolution planning requirements will apply from 2012. The group of G-SIFIs will be updated annually and published each November, starting this year.

The international standards set out in the *Key Attributes of Effective Resolution Regimes* are designed to address gaps in legal frameworks and tools for effective intervention in failing systemic firms, including those that operate in multiple jurisdictions, and to remove impediments under existing national law to cross-border resolution. Their implementation will require legislative changes in many jurisdictions.

There is also a need to significantly step up cooperation amongst authorities to prepare feasible and credible G-SIFI resolution plans, including removing impediment to these firms' resolution. Many jurisdictions also need strengthen their supervisors' resources and mandates so that they have sufficient independence to act and a full suite of powers to proactively identify and address risks.

I ask that you lend your support to make the changes in laws and regulations needed to incorporate the tools and powers for effective resolution in national frameworks, and to strengthen supervisory mandates, resources and powers at national levels.

Strengthening oversight and regulation of shadow banking

You noted in Seoul that stricter bank regulation heightened the need for oversight and regulation of shadow banking to avoid that risky behavior previously taken on by banks is pushed into that unregulated sphere.

We have conducted this year the first of what will be regular comprehensive monitoring exercises to assess risks from the shadow banking system. And we have set work in train to assess the case for regulatory action in five areas we believe are key to contain systemic risks emanating from shadow banking. These are the interactions of banks with shadow banking entities; ways to reduce the susceptibility of money market funds to runs; the regulation of other shadow banking entities on prudential grounds; retention requirements and transparency in securitisation; and the possible regulation of margins and haircuts in securities lending and repos. We will make recommendations in these areas during 2012. In these areas too, laws may have to be changed and hence your support is fundamental.

Implementation of OTC derivatives reforms

Much work is underway to implement the G20 commitments to central clearing, organised platform trading, and reporting to trade repositories by end-2012. While progress is being

made, especially in the largest jurisdictions, a robust global policy framework to support these objectives is not yet fully developed. This framework will require non-discriminatory membership and access criteria to central clearing structures, as well as appropriate safeguards, including cooperative regulatory oversight and access to information on a cross-border basis, and robust standards for the stability and resiliency of the resulting global network of central counterparties. Moreover, a number of potential overlaps, gaps and conflicts in national implementation frameworks need to be addressed.

G20 member authorities should aggressively push forward to address the above issues so as to be able to meet the end-2012 deadline in as many reform areas as possible. The FSB is establishing a senior-level coordination group to prioritise initiatives expedite implementation and support ongoing multilateral work to address these issues. The FSB will continue to closely monitor and review implementation of OTC derivative reforms and report six-monthly on progress.

Implementation of reforms to compensation practices

We have completed a second and very detailed peer review of progress by member countries and firms in implementing the FSB Principles and Standards for sound compensation practices. While good progress has been made, impediments to full implementation remain in some jurisdictions. And firms and supervisors share concerns about a level playing field, particularly concerning pay structure and the interpretation and identification of material risk takers. National supervisors should work bilaterally to verify and, as needed, address specific level playing field concerns raised by their respective institutions. Based on the findings from the ongoing monitoring, the FSB will consider the scope and appropriate timing for a follow-up peer review as well as any decision to issue additional FSB guidance in this area.

Monitoring the implementation of reforms

You have given the FSB the responsibility to coordinate, monitor and report on the complete and consistent implementation of agreed G20 and FSB financial reforms. Implementation covers the period from the development of an international standard or policy through its adoption via changes in laws and regulations at national/regional levels to actual practice by market participants and oversight/enforcement by national authorities. International monitoring of this process, in all its phases, will help ensure complete and consistent implementation across jurisdictions, provide a basis for assessing the effectiveness of agreed policies in achieving their desired results.

The FSB has therefore set up a coordination framework, in collaboration with international standard-setting bodies, to intensify monitoring and public reporting of implementation on a country-by-country basis. This framework will cover the full range of financial regulatory and supervisory reforms, with more intense monitoring in priority areas: the Basel capital and liquidity framework; OTC derivatives market reforms; compensation practices; G-SIFI policy measures; resolution frameworks; and shadow banking.

To communicate implementation progress, we have prepared a scoreboard that tracks progress across the full range of reforms and will update this annually.

Financial stability issues for emerging market and developing economies (EMDEs)

To date, the post-crisis financial reform agenda has understandably focused mainly on addressing the problems of advanced economies, given the sources of problems during the crisis itself. However, it is important that vulnerabilities in other parts of the system receive attention and that EMDE-specific considerations and concerns are taken into account in designing new international financial standards and policies. The FSB, working with staff of the IMF and World Bank, have identified five key issues in this regard: (i) the appropriate pace of application of international financial standards; (ii) promoting cross-border supervisory cooperation and information exchange; (iii) regulation and supervision of small-scale non-bank lending and deposit-taking institutions; (iv) managing foreign exchange risks; and (v) developing domestic capital markets. We will monitor progress in addressing them in 2012.

FSB resources, capacity and governance

A central lesson of this crisis is that financial authorities will need to act more speedily and coherently than in the past, within a system-wide perspective, to fend off incipient stability threats. At the London and Pittsburgh Summits, you took steps in this direction by expanding the membership and strengthening the mandate of the FSB.

Last year you asked the FSB to bring forward proposals for strengthening its capacity, governance and resources so that it can fulfil its mandate and meet growing demands. While we have made progress, a primary constraint in investing the FSB with greater capacity, resources and more articulated governance arrangements arises from its non-legal character. This precludes the possibility of the FSB receiving resources independently, hiring staff in its own name, or entering into agreements with other bodies. While members – and especially the BIS through its Board – have been very supportive of the FSB in terms of resources and facilities, it is not ideal for an organisation with the breadth and weight of the FSB's remit to remain dependent in this way. At the recent G20 Ministers and Governors meeting, the vast majority favoured providing the FSB with legal personality and greater financial autonomy, while preserving the existing and well-functioning strong links with the BIS. They therefore proposed that the next FSB Chair starts the process to examine all the options available for making the FSB a fully enduring organisation, with a view to decisions being made in time for the next Summit.

Yours sincerely,



Mario Draghi

Attachment: Communication on SIFI policy measures