Statement of Mark Carney
Chairman of the Financial Stability Board
to the International Monetary and Financial Committee

Washington, DC, 21 April 2012

Solid progress is being made in the priority areas identified by the G20 Leaders for financial regulatory reforms. These include (i) building resilient financial institutions; (ii) ending "too big to fail"; (iii) strengthening the oversight and regulation of shadow banking activities; (iv) completing OTC derivatives and other reforms to create continuous core markets; and (v) implementing agreed G20 reforms in a timely and consistent manner. In addition, the FSB is working on assessing the implications of post-crisis reforms on emerging market and developing economies (EMDEs), and on strengthening its governance and capacity.

Building resilient financial institutions

Financial institutions are making progress strengthening their balance sheets. While progress varies across countries, and banks in a number of countries still have losses to absorb, both capital and funding liquidity levels are rising. The Basel Committee's most recent assessment shows that banks largely meet the new minimum Basel III requirements of 4.5% for common equity Tier 1 capital (CET1), net of the adjustments for the quality of capital that will be phased in beginning next January. Taking account of the 7% target for CET1 and the surcharge for systemically important banks, the Basel Committee estimates that large banks need to raise over the coming six-year implementation horizon capital in an amount equal to 1.5 times their aggregate profits last year, after tax and before distributions. For smaller banks, the capital shortfall to be met over the same horizon is less than these banks' aggregate profits last year. Hence, although there is considerable variation across banks, the industry in aggregate has the capacity to meet the new targets through earnings retention and reduced distributions over the transition period.

Ending "too-big-to-fail"

The FSB published on 20 April a progress report on the modalities for extending the G-SIFI framework to domestic systemically important banks (D-SIBs). The FSB and Basel Committee are leaning towards a set of principles as a minimum framework for D-SIBs, covering both the methodology for assessing the systemic importance of domestic institutions, and the policy tools that national authorities could apply to contain the systemic risks they pose. Such a principles-based framework would allow for an appropriate degree of national discretion in the assessment and application of policy tools, recognising the different structural characteristics of national financial systems. However, the principles would establish a minimum framework that would ensure compatibility with the G-SIB framework, address the cross-border externalities that the failure of a domestic systemic institution may nonetheless pose, and preserve a level playing field within and across jurisdictions. There remain issues under discussion with regard to the definition of the policy tools, the interaction of the G-SIB and D-SIB regimes and home-host issues more broadly.

Strengthening the oversight and regulation of shadow banking activities

The FSB's second progress on this subject, published on 20 April, describes the advance of work to develop a framework for monitoring and addressing risks posed by the shadow banking system, based on the initial recommendations endorsed by the G20 Leaders at the Cannes Summit. A properly structured and regulated shadow banking sector can make the financial system more robust, efficient and diversified; hence, our reforms in this area seek to mitigate systemic risks while preserving the scope for realizing these benefits. To this end, a number of initiatives are in train. First, to track risks in this sector, the FSB has established and enhanced an annual global data exercise to monitor shadow banking activity, with more jurisdictions participating in the exercise this year. Second, the FSB together with the standard setting bodies are developing regulatory recommendations: (i) to mitigate the spill-over effect between the regular banking system and the shadow banking system; (ii) to reduce the susceptibility of money market funds to "runs"; (iii) to assess and mitigate systemic risks posed by other shadow banking entities than money market funds; (iv) to assess and align the incentives associated with securitisation to prevent a repeat of the creation of excessive leverage; and (v) to dampen risks and pro-cyclical incentives associated with securities lending and repos that may exacerbate funding strains at times of shocks to confidence. The progress report elaborates on the direction of these recommendations. The full set of recommendations will be issued by end-2012.

Creating continuous markets – OTC derivatives reforms

Completing and implementing the agreed reforms to OTC derivatives markets is key to meeting the FSB's priorities of creating continuous markets and ending "too big to fail". As part of those reforms, the G20 Leaders committed at the 2009 Pittsburgh Summit that all standardised OTC derivatives would be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties (CCPs) by end-2012.

To support this commitment, work is well advanced to establish a safe environment for clearing OTC derivatives through a global framework of CCPs. In particular, four safeguards for a global framework have been identified: (i) fair and open access by market participants to CCPs, based on transparent and objective criteria; (ii) cooperative oversight arrangements between all relevant authorities, both domestically and internationally, that result in robust and consistently applied regulation and oversight of global CCPs; (iii) resolution and recovery regimes that ensure the core functions of CCPs are maintained during times of crisis and that consider the interests of all jurisdictions where the CCP is systemically important; and (iv) appropriate liquidity arrangements for CCPs in the currencies in which they clear. CPSS and IOSCO published today Principles for Financial Market Infrastructures, which set international standards that will go a long way to achieving these safeguards. Adherence by authorities and their CCPs to these Principles will substantially advance this agenda.

Substantial progress by mid-2012 on all the four safeguards will help to create a resilient and efficient environment for global clearing. This will allow national authorities to make informed decisions on the appropriate form of CCPs to meet the G20 commitment to centrally clear all standardised OTC derivatives by the end of 2012. The FSB OTC Derivatives Coordination Group, which comprises the Chairs of the BCBS, CGFS, CPSS and IOSCO and FSB, is monitoring and coordinating the international work to achieve the progress on the safeguards that is needed by mid-2012.

Improving transparency and data collection is very important not only in derivatives markets, but in financial markets more generally. The global Legal Entity Identifier (LEI) initiative aims to put in place a system that will deliver unique identifiers and relevant associated data (e.g. name, address, ownership) to entities participating in financial markets across the globe, so as to enhance counterparty risk and collateral management. The FSB is on track to meet the mandate from Cannes to provide recommendations on the governance framework for such a global LEI to the Los Cabos Summit, as well as concrete proposals for the implementation of the system. The proposals are likely to include the development of a global LEI Charter or Accord that sets out the objectives of the LEI and the associated global governance arrangements to protect the public interest, as well as proposals to facilitate the development of the operational components of the global LEI system in an open and transparent manner in accordance with the interests of the global regulatory community.

Creating continuous markets – Convergence of IASB-FASB accounting standards and strengthening of IASB governance

The IASB and FASB are making progress on projects to converge their standards on financial instruments, including a joint expected loss impairment ("provisioning") approach and a more converged approach to classification and measurement. Important improvements to their standards on financial instruments, fair value and off-balance sheet entities were finalised in 2011. A joint update report from the two standard setters was published by the FSB on 20 April. The IASB and FASB will conduct further public consultations in the second half of 2012, and expect to issue final converged standards in a number of key areas by mid-2013. The two Boards have extended certain project target completion dates in order to allow sufficient time for outreach and public comment on the large number of planned major Exposure Drafts, and for the Boards to reflect that feedback in high-quality final standards.

The FSB supports the efforts of the IASB and FASB to achieve convergence to a globally accepted set of high-quality accounting standards and urge them to issue final converged standards on key projects by mid-2013.

Separately, reforms were announced in February 2012 by the IFRS Foundation (IFRSF) Trustees and the IFRSF Monitoring Board to improve the governance of the IASB. These include reforms that seek to enhance the involvement of key stakeholders, including those from emerging market economies, and the technical dialogue of the IASB with market regulators, investors and prudential authorities. The IASB's report on these governance reforms was published by the FSB as part of the same document as the joint update report from the IASB and FAASB mentioned above.

Timely and consistent implementation of reforms

The success of the financial regulatory reform programme depends on the timely, complete and globally consistent implementation of these policies. FSB member jurisdictions have made a commitment to lead by example. It is important to monitor, assess and report on the implementation of agreed reforms to ensure that jurisdictions live up to their commitments and the reforms necessary to improve safety and soundness are made.

The FSB and the standard-setting bodies are rigorously monitoring the implementation of agreed G20 reforms under the Coordination Framework for Implementation Monitoring established last year, with particularly intensive and detailed monitoring in six priority reform areas. The FSB will report to the June Summit on progress across the range of reforms. This reporting will include separate progress reports on the three priority areas where reforms are furthest advanced (Basel III, OTC derivatives, compensation practices), together with an overall overview progress report and an updated scoreboard of reforms.

Assessing the implications of post-crisis reforms EMDEs

The FSB is working closely with the IMF, World Bank and standard-setting bodies, as well as a wide range of national authorities both within and outside the FSB's membership, on a study of the effect of regulatory reforms on EMDEs, including the extent to which they may have had unintended consequences. The FSB will report on the findings to the June G20 Summit.

Strengthening the governance and capacity of the FSB

Good progress is also being made by the High-Level Working Group examining options for placing the FSB on a more enduring organisational basis, with greater resources and strengthened institutional underpinnings.

In closing, the global community has agreed to an ambitious, but necessary, range of financial reforms. Work is proceeding across a number of fronts to advance this agenda. The sustained commitment and cooperation of countries throughout the world will be necessary to complete it.