

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

Washington, DC, 12 April 2014

Vulnerabilities in the financial system

The global economy has been improving, and monetary policy in the US is in the early stages of a normalisation process, after an extended period of exceptional accommodation. A comprehensive programme of regulatory reforms and supervisory actions since the crisis has made the global financial system more resilient. Currently, European authorities are putting in place a comprehensive set of measures to strengthen further the region's financial system. Emerging markets have coped relatively well to date with occasional bouts of turbulence, in part reflecting the positive impact of both past and more recent reforms.

However, the improved global outlook does not diminish the need to continue to strengthen financial resilience. Financial markets should be prepared for the possibility of sharp adjustments in interest rates, exchange rates, valuations of financial instruments, market volatility and liquidity. Some emerging markets may experience a combination of slower growth, capital outflows and higher borrowing costs which may expose vulnerabilities, associated with the rapid growth of credit in recent years and increased use of foreign currency borrowing by the non-financial corporate sector.

Meanwhile, the ongoing search for yield by investors continues to put upward pressure on valuations in a sub-set of markets, such as higher-yielding credit markets, and may lead to higher inflows into alternative assets, such as commercial real estate. Authorities need to remain vigilant to deteriorating underwriting standards and the build-up of leverage within the financial system, including the shadow banking system.

Progress in financial reforms

G20 Leaders in St. Petersburg in September 2009 agreed priorities for substantially completing the core programme of fundamental reform of the global financial system during the Australian Presidency. We are on-track to deliver for the Brisbane G20 Summit, but difficult decisions remain to be taken in three particular areas:

- Ending too-big-to-fail;
- Transforming shadow banking to transparent and resilient market-based financing; and
- Making derivatives markets safer.

Ending too-big-to-fail

It is essential that systemically important institutions can be resolved in the event of failure without the need for taxpayer support, while at the same time avoiding disruption to the wider financial system. The expectation that systemic institutions can privatise gains and socialise losses encourages private sector risk-taking and can be ruinous for public finances.

Gone-concern loss-absorbing capacity

The FSB is developing proposals by the end of this year on the adequacy of global systemically important financial institutions' loss-absorbing capacity when they fail. This 'gone-concern loss-absorbing capacity', or GLAC, is vital for home and host authorities to have the ability and confidence, as well as for private markets to recognise, that systemically important banks can be resolved safely, without the use of public funds, while taking account of differences in national resolution regimes.

Further intense work is needed ahead of the Brisbane Summit on three issues:

- The criteria that bank liabilities should meet to be considered as GLAC. Eligible liabilities should be available to incur losses at the point of resolution in a manner consistent with the creditor hierarchy. Authorities are examining a wide range of liabilities, including common equity in excess of regulatory requirements, which could meet these criteria.
- The appropriate amount of GLAC that systemically important banks should hold. If it can be agreed, a common minimum GLAC standard for all globally systemic banks will increase confidence among home and host authorities that there is a minimum amount of resources available in resolution to absorb losses.
- Where in the structure of banking groups that GLAC should be held. We are examining a range of options given diverse banking models, but the necessary requirement is effectiveness. The location of the GLAC will need to reflect the resolution strategy for each firm, so this work will draw on the findings of the Resolvability Assessment Process for individual global systemically important banks that will involve both home and host authorities.

After the Brisbane Summit, the proposal will be:

- Submitted for public consultation and be subject to a comprehensive quantitative impact assessment;
- Applied to the Resolvability Assessment Process for each of the current 29 global systemically important banks, before being finalised in 2015; and
- Based on these processes, adjustments to the GLAC framework would be made, as appropriate.

Cross-border resolution actions

The resolution of cross-border banks must be supported by contractual or statutory approaches for cross-border recognition of resolution actions, including temporary stays on close-out and cross-default rights in financial contracts when a firm enters resolution, and bail-in of debt issued under foreign law. For the Brisbane Summit:

- The FSB is working with the financial industry to establish a contractual approach to temporary stays.
- National authorities need to be empowered to co-operate fully with their counterparts in other countries, including by recognising foreign resolution actions and ensuring that debt issued under foreign law includes contractual recognition provisions so that bail-in is effective in a cross-border context.

Other measures to end too-big-to-fail

- The FSB has this month published a progress report on its work to strengthen supervisory intensity and effectiveness.
- FSB Members have reviewed an interim assessment, produced by the FSB in collaboration with the IMF and OECD, of the cross-border consistency and global financial stability implications of planned or implemented domestic structural banking reforms in individual jurisdictions. Many of these measures help address the too-big-to-fail problem, but also have impacts on financial institutions and markets in third countries. That work will be developed and the FSB will report on this to the Brisbane Summit.
- The International Association of Insurance Supervisors (IAIS) will finalise for the Brisbane Summit a Basic Capital Requirement on which higher loss absorbency for global systemically important insurers will be built. This work is progressing well.

Transforming shadow banking

The FSB is working to strengthen the oversight and regulation of shadow banking according to the roadmap agreed by Leaders at St Petersburg. The FSB has:

- Agreed an information-sharing process to support implementation of the policy framework for oversight and regulation of shadow banking entities other than money market funds;
- Developed further the policy framework to address financial stability risks associated with securities financing transactions. This follows a review of the results of the public consultation and a further comprehensive quantitative impact study. An implementation timetable for the policy recommendations in this area has been agreed and will be published.

- In addition, the BCBS has finalised its supervisory framework for large exposures, to be published shortly, and risk-sensitive capital requirements for banks' investments in equity of funds, to mitigate spill-over effects between banks and shadow banking entities.

Ahead of the Brisbane Summit:

- The FSB will start information sharing among authorities in May and will report initial findings.
- The framework for haircuts and haircut floors in repo and securities financing transactions will be finalised.

After the Brisbane Summit:

- The FSB will launch a peer review on national implementation of the high-level policy framework in 2015.

Making derivatives markets safer

National implementation of agreed OTC derivatives reform is overdue, but substantial progress is being made in addressing the remaining cross-border issues.

- The BCBS has finalised, and will publish ahead of our meeting, capital standards for the treatment of banks' exposures to central counterparties that will clear OTC derivatives trades.
- The OTC Derivatives Regulators Group (ODRG) has provided a report setting out the remaining known cross-border implementation issues relating to OTC derivatives reforms.

Ahead of the Brisbane Summit:

- The ODRG will provide further reports in September and November on how it has addressed, or intends to address, the identified cross-border implementation issues.
- The FSB will publish a report in September on the established processes in each jurisdiction to enable deferral to the OTC derivatives rules of others where these achieve similar outcomes.
- The FSB will publish a report in May on approaches to aggregating and sharing derivatives data amongst authorities. It is crucial that the data that will become available under new trade reporting rules can be used by authorities to monitor global financial stability, even though they will be reported to multiple trade repositories.