

## **To G20 Finance Ministers and Central Bank Governors**

This year marks the ten-year anniversary of the founding of the Financial Stability Board by the G20 Leaders. The G20 Leaders agreed that post-crisis reforms to a global financial system require cross-border cooperation and a framework of internationally agreed high standards. Over these past ten years, the FSB proposed and guided the development of critical reform initiatives in a number of areas and worked with international standard-setting bodies and international organizations to build a more resilient financial system, addressing the fault lines that caused the global financial crisis.

The development of those policies is nearly complete and implementation is well underway. The FSB's 5<sup>th</sup> annual report on implementation and effects of reforms, which we are submitting to the G20 at its October meeting, confirms that these efforts have resulted in a number of tangible accomplishments: a stronger banking system that holds more loss-absorbing capital and higher levels of liquidity; derivatives markets that are more transparent; and securitizations that are less complex. More generally, those aspects of non-bank financial intermediation that contributed to the financial crisis have substantially declined and no longer pose risks to financial stability.

Yet our mission is far from complete. This is certainly the case with respect to the agreed G20 reforms, where implementation progress remains uneven across key reform areas, and where we are in the process of evaluating that reforms are working as intended. Moreover, looking ahead, we need to be ready to address evolving risks to global financial stability, be they related to current downside risks to growth and uncertainties around Brexit, or structural changes in the financial system, such as the growing role of non-bank financial intermediation.

### **Ensuring resilience in the face of new risks**

The outlook for global growth has started to weaken and become more uncertain. Declining long-term interest rates have supported risky asset prices. Corporate and public debt levels continue to rise. And financial markets now expect very low, or even negative, interest rates to persist for the foreseeable future.

These increasing risks meet a financial system that is much more resilient than it was before the financial crisis. However, the long period of sustained global growth and rising asset prices may have weakened the incentives to take precautions against unforeseen events. The prospect of a continued environment of 'search for yield' reinforces the case for identifying and addressing emerging risks to financial stability early on. In that vein the FSB is developing a new surveillance framework, to be put in place by next year. Drawing on the experience of the FSB's

expert and diverse membership, the new framework will support comprehensive, methodical, and disciplined assessment of vulnerabilities.

A forward-looking approach includes a thorough analysis of conjunctural risks. The FSB is conducting an in-depth analysis of the markets for leveraged loans and Collateralized Loan Obligations (“CLOs”), which have grown significantly in recent years. This study, a summary of which I expect the FSB will issue by end-2019, assesses the vulnerability and potential financial stability implications of developments in these markets. Areas of potential concern include: higher levels of corporate debt; weaker lending standards and creditor protections; and increased complexity and opacity, which makes it difficult to assess potential spillovers and risks from interconnectedness; and concentration of risks in a few big financial institutions. This recent assessment complements analyses conducted by FSB member jurisdictions and aims to provide an aggregated and global perspective, as well as point to areas where data gaps remain.

Another aspect of forward-looking financial stability policy concerns the implications of structural changes in the financial system. In this regard, the continued shift of financial intermediation to non-banks requires our attention. While non-bank finance adds to the diversity of funding opportunities, it may also bear new risks for financial stability. The FSB’s global monitoring of developments in non-bank financial intermediation is uniquely placed to identify such potential risks.

It is vital that the resilience of non-bank finance is promoted and maintained as it evolves. To this end, the FSB’s 2017 recommendations to address structural vulnerabilities from asset management activities will be made operational by IOSCO this year. Once implementation is progressed, IOSCO and FSB will assess if these recommendations have been implemented effectively, and the FSB will report back to the G20.

Moreover, technological innovation in the financial sector continues apace. This offers potentially huge benefits, not least in terms of efficiency and inclusiveness. However, rapid progress can also present challenges. The FSB has continued its work on the potential financial stability implications of the entry of large technology firms into financial services and from third-party dependencies, including in cloud services. At the same time, financial institutions are themselves increasingly drawing on advances in big data, artificial intelligence and machine learning. The FSB in its coordination role will be working with standard-setting bodies and international organizations to gather information on relevant developments and propose regulatory responses if necessary.

Finally, there are new types of risk that authorities and the private sector need to address, first and foremost cyber risk. Considering the interconnectedness of the financial ecosystem, a financial institution’s response to and recovery from a cyber incident is critical in limiting the risk of contagion and its effects to financial stability. As part of the FSB’s efforts to enhance cyber resilience, the working group on cyber incident response and recovery has been tasked to identify effective practices to help financial institutions respond to and recover from cyber incidents. The work will also take into account the potential cross-border nature of cyber incidents.

## **Potential financial stability issues from global stablecoins**

G20 Leaders, in the Osaka Declaration, noted that crypto-assets do not pose a threat to global financial stability at this point, but that they remain vigilant to existing and emerging risks. However, the introduction of “global stablecoins” could pose a host of challenges to the regulatory community, not least because they have the potential to become systemically important, including through the substitution of domestic currencies. These include challenges for financial stability; consumer and investor protection; data privacy and protection; financial integrity including AML/CFT and know-your-customer compliance; mitigation of tax evasion; fair competition and anti-trust policy; market integrity; sound and efficient governance; cyber security and operational risks; and an appropriate legal basis.

At the same time, G20 Leaders also noted that technological innovations can deliver significant benefits to the financial system and the broader economy. Global stablecoins might offer a vehicle for cross-border payments and remittances for a large number of users.

Stablecoin projects of potentially global reach and magnitude must meet the highest regulatory standards and be subject to prudential supervision and oversight. Possible regulatory gaps should be assessed and addressed as a matter of priority. It is against this backdrop that the G20 Leaders asked the FSB to advise them on any additional multilateral responses as needed, given recent developments. The FSB is assessing how the existing regulatory framework applies to “global stablecoins” and whether any regulatory gaps need to be filled. In any case, it is essential to apply the principle of ‘same activity – same rules’, independent of the underlying technology. National authorities are exchanging information on how best to apply supervisory practices to these new areas.

The G7 working group on stablecoins is delivering a preliminary assessment of opportunities and challenges posed by “global stablecoins”. The G7 working group will be handing off work on regulatory issues to the FSB, and we have already begun work in this area. The FSB has formed a working group, which is tasked with examining the regulatory issues raised by stablecoins that have the potential to reach global scale, taking into account the perspective of emerging markets and developing economies. The group’s work should inform policy approaches that harness the benefits of financial innovation, while addressing associated risks for the financial system, and advise on possible multilateral responses as necessary.

The FSB is submitting an issues note on global stablecoins to the October 2019 G20 Finance Ministers and Central Bank Governors meeting. The FSB will submit a consultative report to the G20 Finance Ministers and Central Bank Governors in April 2020, and a final report in July 2020.

## **Promoting a financial system that supports strong and sustainable global growth**

Since my letter to G20 Leaders in June 2019, the FSB has been working on a number of initiatives to promote a global financial system that is resilient and supports global growth.

The FSB’s work on the cloud services and stablecoins are examples of how it is already working to ensure the resilience of the financial system and avoid fragmentation, in relation to the

challenges presented by technological innovations, in line with its mandate. The FSB is considering how to structure the way it approaches these issues. By doing so, the FSB will reinforce its role as a forward-looking forum for regulatory and supervisory initiatives with cross-border relevance.

The FSB is also, as part of the post-crisis agenda, addressing instances of harmful market fragmentation. Following up on its June report, work is continuing on market fragmentation, cross-border trading and clearing of OTC derivatives, cross-border management of capital and liquidity, and international sharing of data and other information. The FSB hosted a workshop in September, which included financial industry representatives and academics, to explore issues of market fragmentation, specifically those issues arising from pre-positioning of capital and liquidity. The FSB is submitting a progress report to the G20 on its further work on market fragmentation, in collaboration with international standard-setters, including IOSCO follow-up on how cross-border deference in regulation and supervision is applied, and practical steps the FSB can take to enhance supervisory and regulatory coordination more generally.

In July, the FSB published a review of the implementation of the Total Loss Absorbing Capacity (TLAC) Standard for G-SIBs--the standard was adopted by the FSB in 2015. There has been steady and significant progress in both the setting of external TLAC requirements by authorities and issuance of TLAC by G-SIBs. All relevant G-SIBs meet or exceed the TLAC target ratios set by the FSB. The FSB's Resolution Steering Group is working on the challenge of ensuring that, in a crisis, TLAC will be effectively available in the right amounts where needed within a group.

Workable resolution frameworks are not only key to addressing the too-big-to-fail (TBTF) problem, they also facilitate structural change in the banking system without adverse consequences for financial stability.

The FSB is taking forward its multi-year program of rigorous evaluation of post-crisis reforms. The latest evaluation, of the effects of those reforms on small and medium-sized enterprises (SMEs), is nearing completion. We are currently reviewing public comments and a final report will be issued in November. The evaluation of the effects of TBTF reforms for banks is underway. This two-year study has been designed to assess whether the implemented TBTF reforms are reducing the systemic and moral hazard risks associated with systemically important banks. It will also examine the broader effects of the reforms to address TBTF for banks on the overall functioning of the financial system. A workshop on TBTF issues was held in New York recently.

There are many benefits that could be realised by full implementation of the global Legal Entity Identifier (LEI), including – but not limited to – use within RegTech and SupTech, and also supporting timely data processing in the case of an authority having to deal with a failed financial institution and all of its related legal entities. Notwithstanding this progress, the LEI has far to go to meet the G20's objective of truly global LEI adoption--the FSB this year published recommendations to deliver on this fundamental post-crisis reform.

## Conclusion

The FSB has delivered on a number of projects under the Japanese G20 Presidency, which is coming to a successful end. These projects – ranging from addressing harmful market fragmentation to analyzing the potential implications of a greater use of decentralized technologies – underscore the FSB’s pivot from fixing the fault lines of the global financial crisis to addressing new risks.

That being said, the full, consistent and timely implementation of all agreed reforms remains a priority. Our annual report therefore emphasizes the need for continued support from the G20 in implementing the agreed reforms and reinforcing global regulatory cooperation.

The FSB’s priorities therefore are a combination of finishing what has been agreed, checking that we have achieved the intended results, and focusing our additional efforts on identifying and addressing new risks in a way that preserves the benefits of the financial innovation that is needed to support the G20’s objective of strong, sustainable and balanced global growth.

We look forward to working with the upcoming Saudi Arabian G20 Presidency to continue this crucial work.

Yours sincerely

A handwritten signature in black ink, appearing to read "Randal K. Quarles". The signature is fluid and cursive, with a large, prominent loop at the end.

Randal K. Quarles