FINANCIAL STABILITY BOARD

THE CHAIRMAN

7 November 2014

To G20 Leaders

Financial Reforms: Completing the Job and Looking Ahead

In Washington in 2008, the G20 committed to fundamental reform of the global financial system. The objectives were to correct the fault lines that led to the global crisis and to build safer, more resilient sources of finance to serve better the needs of the real economy. This letter reports on progress and highlights the major issues that demand the attention of Leaders. It makes four points.

First, the job of agreeing measures to fix the fault lines that caused the crisis is now substantially complete. Strengthened international standards are building more resilient financial institutions and more robust markets. As well, actions are being taken to guard against systemic risk arising from the migration of risky activity to elsewhere in the financial system.

Second, the endorsement by Leaders of proposals to end Too Big To Fail in the banking sector will be a watershed. Once implemented, these agreements will play important roles in enabling globally systemic banks to be resolved without recourse to public subsidy and without disruption to the wider financial system.

We must now build on these successes in order to create a financial system that fully supports the G20's objective of strong, sustainable and balanced growth. This means:

Third, as we enter the next phase of financial reform, the FSB will adjust focus towards addressing new and constantly evolving risks and vulnerabilities. Many of these risks arise from outside the core of the financial system. The ongoing support of the G20 is essential to build the new focus and, where appropriate, to develop common responses to promote global financial stability. Sharing of data, analytics and policy choices will be vital. The FSB is the platform for doing so.

Fourth, the support of G20 Leaders is now needed for the next phase of the FSB's work to promote a system based on mutual trust and co-operation. This is essential to help maintain an open global financial system. Building trust relies on consistent implementation of agreed common standards; on the recognition that each jurisdiction will need to take account of its own circumstances while implementing internationally agreed minimum standards; and on deferral to the regulatory regimes of others as set forth by Leaders in St Petersburg, so that inefficient duplication and conflicts of regulation can be avoided.

To ready itself for its new roles, the FSB has agreed changes to the structure of its representation, strengthened the inclusiveness of its working procedures and agreed to supply more public information about its operations. The endorsement of these changes by Leaders will increase the FSB's responsiveness to the increasingly important role of emerging markets in the global economy while maintaining its effectiveness as a decision-making body.

1. THE JOB OF AGREEING MEASURES TO FIX THE FAULT LINES IS SUBSTANTIALLY COMPLETE

As detailed in comprehensive progress reports, the priority actions agreed by Leaders at past G20 Summits are now substantially complete. In summary:

Banks are more resilient

Capital requirements are much higher and of much higher quality. Large internationally-active banks are on course to meet those requirements four years ahead of the implementation deadline. Where these new standards have been implemented decisively, access to credit has returned and supported economic recovery.

To ensure that depositors, investors, clients and regulators have full confidence in the strength of bank balance sheets, a common standard for leverage has been agreed and the Basel Committee has set out a plan to address worryingly large differences in the risk models that banks use to calculate their capital needs. To ensure banks can withstand turbulence, standards have been agreed to enhance the resilience of banks' funding and their stocks of liquid assets. Reforms to compensation practices are largely completed.

Shadow banking is being transformed into resilient market-based financing for the real economy

One of the causes of the financial crisis was the rapid-but-opaque growth of activities and non-bank institutions that involved borrowing short-term, lending long-term, often with substantial leverage. The FSB has taken a number of steps to mitigate these risks and to prevent new systemic risks arising from the migration of these activities as regulation of the core system has tightened.

Money market funds have been made more resilient. Measures have been agreed to constrain the leverage of institutions that borrow from banks using their assets as security, and a supervisory framework has been agreed to limit the exposure of banks to certain non-bank institutions.

The Shadow Banking Roadmap agreed by Leaders at St Petersburg to strengthen the oversight and regulation of shadow banking has been updated for your endorsement, to build further on the already significant policy work in this area.

It is important to recognise that certain activities referred to as "shadow banking" are often, in fact, direct or other forms of market-based finance. The development of such financing mechanisms is important for many economies to lessen reliance on the formal banking system and to build the diversity and resilience of the financial system as a whole. When properly structured, market-based finance can play a vital role in financing infrastructure and SMEs.

Derivative markets are becoming safer. Nevertheless implementation of standards is uneven and behind schedule

The crisis highlighted how the interconnectedness of the major institutions and markets could lead to rapid contagion when markets and liquidity suddenly dried up. Derivative markets are becoming safer and less opaque. Requirements are now being imposed, and incentives are being created, for banks to centrally clear derivative trades.

Despite this progress, the ongoing commitment of Leaders is needed to implement derivatives reform consistent with the Pittsburgh Summit commitments, and to help ensure cross-border consistency of rule-making. This will promote safe and transparent markets. Moreover, more widespread adoption of requirements will preserve the advantages of international risk-sharing through these markets.

To support market functioning, financial market benchmark rates are being reformed, and FSB members are studying appropriate measures to enhance the fairness and effectiveness of markets.

Comprehensive data on derivative trades is being collected so that authorities can keep track of where risks lie. G20 support is required to remove legal barriers that exist in some jurisdictions that block the reporting and sharing of counterparty information.

2. ENDING TOO BIG TO FAIL

Notwithstanding the substantial progress in fixing the fault lines that underlay the crisis, the integrity of the package of reforms rests on implementing credible reforms to end Too Big To Fail.

The world's largest banks threatened the stability of the global system and their public bail-outs undermined both market discipline and a sense of fairness in our societies. As G20 Leaders have directed at prior Summits, it is essential that all systemically important financial institutions can be resolved in the event of their failure without the need for taxpayer support and without disruption of the wider system or real economy.

Global systemically important banks (G-SIBs) and insurers have been identified. They are being required to meet more stringent standards and are subject to more intensive supervision. Resolution regimes with the necessary tools to deal with the failure of G-SIBs are coming into place.

Agreement has now been reached on two additional proposals that, with the endorsement of Leaders, will be a watershed in ending Too Big To Fail for banks. They will:

- promote a level playing field for globally systemic banks while taking into account differences in national resolution regimes;
- give confidence to host nations, particularly emerging economies, that they won't again be side-swiped by the failure of a large advanced economy bank; and
- instil greater market discipline by working to remove implicit government subsidies.

It is important to recognise that success in ending Too Big To Fail may never be absolute because financial institutions cannot be insulated fully from all external shocks. But these proposals will change the system so that individual banks bear the costs of their own actions, and the consequences of the risks they take.

The first agreement is a proposal for a **common international standard on the total loss absorbing capacity that globally systemic banks must have.** It will ensure that shareholders and creditors who benefit in the normal course of business also absorb losses when banks fail. Clear principles have been established to underpin the standard, and there is a detailed term sheet specifying the amount, type, structure of, and disclosure requirements around that capacity. With the endorsement of Leaders, these proposals will now be subject to public consultation and rigorous impact assessments with the intent of finalising them by the next Leaders' Summit in 2015.

The second is an **industry agreement to overcome the lack of a global framework to prevent cross-border counterparties taking their money before others when a bank needs to be resolved.** The agreement will prevent cross-border derivative contracts being disruptively terminated in the event of a globally systemic bank entering resolution. The agreement of the 18 largest dealer banks, representing 90% of derivative activity, will make cross-border resolution of banks much more realistic. National authorities will use regulatory and supervisory actions to support comprehensive industry adoption of the agreement. More fundamental regulatory action will be needed in the medium term in order to secure the same outcome through statute.

Going forward, the support of Leaders is needed to deliver national implementation of resolution regimes and standards for banks; to empower national authorities to work with counterparts in other countries to agree and execute plans to resolve individual banks; and to end Too Big To Fail outside the banking sector.

3. ADJUSTING FOCUS TOWARDS NEW AND CONSTANTLY EVOLVING RISKS

As the fault lines that caused the crisis are substantially addressed and the associated reforms implemented, the FSB will adjust focus towards new and constantly evolving risks and vulnerabilities in the global financial system. We must continue to manage the system dynamically and effectively. That will require demonstrated willingness to adjust in the face of new information and new challenges, for example, strengthening cyber resilience.

Many of these new risks could arise from outside traditional banking institutions. In this regard, reforms that guard against significant risks migrating from more tightly regulated banks to other parts of the system will provide some protection. Our new framework for oversight of shadow banking requires ongoing review of the regulatory perimeter and policy responses proportionate to the financial stability risk posed. The constantly evolving structure of the financial system and shape of these new risks demands a flexible, adaptive approach.

The FSB provides a platform for authorities to assess market developments and respond when needed. Sharing of data, analytics and policy choices will be vital to allow national authorities to understand and react to new risks in a timely way. The FSB is also taking actions to promote information sharing on shadow banking to ensure data can be efficiently and effectively used to monitor and address risks to global financial stability.

4. THE NEXT PHASE: BUILDING TRUST AND CO-OPERATION

The G20 and FSB can now look ahead to how, collectively, authorities will regulate and supervise the global system. By building mutual trust we can realise fully the benefits of an open, integrated and resilient global financial system.

That job is not straightforward because, although markets and many financial institutions are global, regulation remains national or regional. Concerns about spillovers from failures of foreign institutions, or market contagion starting elsewhere, can prompt jurisdictions to safeguard themselves unilaterally, given that a national regulator's first responsibility is to do its utmost to ensure the safety and soundness of its home jurisdiction.

To build trust across jurisdictions and to be effective, the system must be founded on consistent implementation of agreed common international standards. To be efficient, that trust must be drawn on to deepen co-operation.

The industry too must play a role and improve its own culture, ethics and governance. Such industry efforts must reinforce potential changes to market structure and practices in order to restore fully public trust in key fixed income, foreign exchange and commodity markets following a spate of conduct scandals in recent years.

The support of Leaders for the next stage of managing the global financial system is required in two areas.

Consistent implementation to make standards effective and build mutual trust

Common international standards that have been agreed must now be implemented fully, consistently and in a timely way. To promote that, the FSB has established a programme of peer reviews to assess the performance of individual G20 members. The latest findings of our monitoring process are summarised in the attachment to this letter.

From next year, the FSB will begin an annual reporting process on implementation. That process will seek to highlight both shortcomings and good practice, and will seek to assess whether reform measures are having unintended effects and must therefore be adjusted. The FSB's work will include focus in particular on the effects in emerging markets. When a robust analysis is completed, the FSB will be prepared to draw lessons from these reviews to refine the regulatory framework. The ongoing commitment of G20 members is needed to address the outcomes of those reviews.

Co-operation to manage the system effectively

Co-operation will help enable regulation to be both more effective and more efficient. Jurisdictions differ in their stage of financial development and their degree of integration into the global economy. Implementation must take those differences into account, so it can be appropriate for the same standards to be implemented in different ways across jurisdictions.

With respect to OTC derivatives regulation, G20 Leaders agreed in St Petersburg that regulators should be able to defer to each other in the cross-border application of derivatives regulations when justified by the quality of their respective regulatory and enforcement regimes, based on similar outcomes, in a non-discriminatory way, paying due respect to home country regulation regimes. Progress has been made, but greater urgency is required if we are to alleviate reductions in market liquidity by promoting appropriate use of deference in line with your agreement in St. Petersburg. The continued support of the G20 is needed to further this work and to consider whether and where more widespread adoption of flexible outcomes-based approaches to resolving cross-border market regulation issues can be used.

CONCLUSION

The G20 has worked intensively over the past six years to correct the fault lines that led to the global financial crisis. Under the Australian G20 Presidency, progress has been made across all policy areas, including the landmark agreement on total loss absorbing capacity for the world's largest banks, so that the job is now substantially complete. However, further work remains in order to build a fully resilient system.

The FSB is fully committed to supporting the G20 in its continuing efforts to strengthen the resilience of the global financial system. The challenges for the FSB in the next phase of our work are to monitor and address new and evolving risks; to build mutual trust through consistent implementation of benefits of reforms; and to manage the system both effectively and efficiently. In these ways we can fully realise the an open global system: the only system that can finance the investment and trade necessary to serve all economies and deliver strong, sustainable, balanced growth across the G20.

Yours sincerely,

Mark Carney

FINANCIAL STABILITY BOARD

STANDING COMMITTEE ON STANDARDS IMPLEMENTATION

9 November 2014

Implementation Progress Dashboard

Section A: Implementation Status

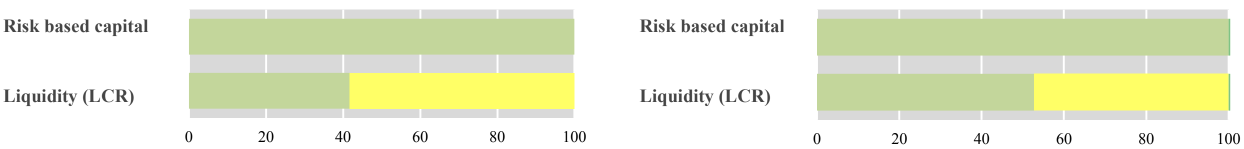
I. Building resilient financial institutions

Implementation of the Basel III framework is on track (Figure 1).

- All FSB jurisdictions have Basel III risk-based capital rules in force in accordance with the agreed timetable. Capital regulations of seven members (representing 30% of the market) have been assessed by the Basel Committee and deemed consistent with Basel III standards.
- Ten jurisdictions already have liquidity rules (LCR) published or in force, while the remainder are still in the implementation process. The LCR has to be in force at the beginning of 2015.

Implementation of Basel III framework **Figure 1**

As per cent of number of FSB jurisdictions **As per cent of market size**[1]



Final rule in force (for LCR, final rule in force or will come into force on 1 January 2015)
Draft regulation published
Draft regulation not published

1 Market size based on assets of banks domiciled in each FSB jurisdiction at end-2013.

Implementation of compensation reforms is largely completed.

- Almost all FSB jurisdictions have now fully, or almost fully, implemented the FSB *Principles* and *Standards for Sound Compensation Practices*.
- The focus now is on embedding oversight of compensation practices in supervisory frameworks and refining national regulatory frameworks (e.g. on material risk takers).

II. Making derivatives markets safer

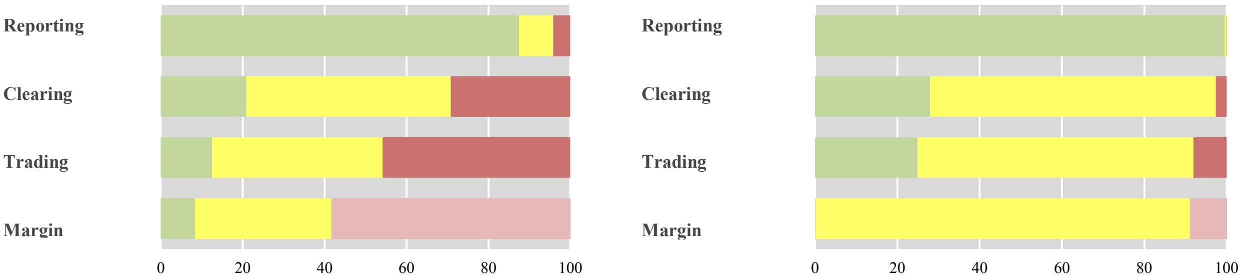
Implementation of OTC derivatives reforms is uneven and two years behind schedule (Figure 2).

- Trade reporting requirements are in place (fully or partly) in all except three FSB jurisdictions. However, authorities continue to report challenges regarding the access to and usability of data held by trade repositories.
- Five jurisdictions (representing less than 30% of the market) have some central clearing requirements in force; this is expected to increase to fifteen jurisdictions by end-2015.
- Three jurisdictions have trading requirements in place for certain types of OTC derivatives, while several others have recently taken additional implementation steps in this area.

- Jurisdictions are at various stages of adopting the BCBS-IOSCO margin requirements for non-centrally cleared derivatives, which are expected to be phased-in beginning in December 2015.

Implementation of OTC derivatives reforms **Figure 2**

As per cent of number of FSB jurisdictions **As per cent of market size**[1]



Final regulations fully/partially effective
Implementing regulations fully/partially adopted but not effective, or in consultation/proposed
Draft implementing regulations not yet published (dark red colour indicates that deadline for reform has lapsed)

1 Market size based on single currency interest rate derivatives gross turnover in April 2013 (BIS 2013 Triennial Survey).

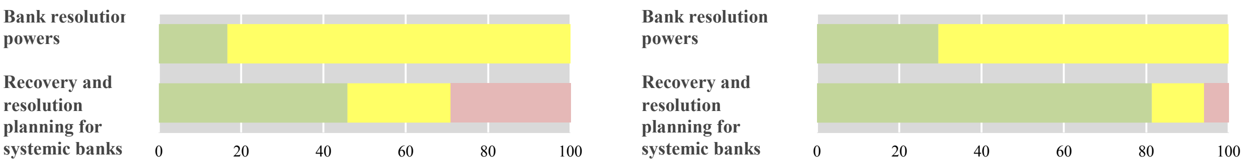
III. Ending too-big-to-fail

Substantial work remains on the implementation of effective resolution regimes (Figure 3).

- All G-SIBs have recovery plans in place, and most home authorities report that they have developed high-level resolution strategies and completed initial operational resolution plans.
- Cross-border crisis management groups have now been established for all G-SIBs and G-SIIs.
- However, few jurisdictions have resolution regimes that are fully aligned with the *FSB Key Attributes of Effective Resolution Regimes*, even in the banking sector where implementation is most advanced. Most members have not yet adopted bail-in powers or mechanisms to give effect to foreign resolution actions, and fewer than half of FSB jurisdictions have adopted recovery and resolution planning for all systemic domestically incorporated banks.

Implementation of effective resolution regimes **Figure 3**

As per cent of number of FSB jurisdictions **As per cent of market size**[1]



Implemented/in place
Partially implemented/in place
Not implemented/in place

1 Market size based on assets of banks domiciled in each FSB jurisdiction at end-2013.

IV. Transforming shadow banking into resilient market-based financing

Implementation of policy measures for shadow banking has begun.

- The FSB will begin the reporting of implementation progress on shadow banking reforms from 2015, drawing on monitoring and peer review work by relevant monitoring bodies.
- The preliminary findings from IOSCO peer reviews, based on self-assessments by participating jurisdictions, indicate that progress is being made in adopting reforms on money market funds and on aligning incentives for securitisation.

Section B: Key Issues and Challenges

I. Cross-border cooperation

- From a cross-border perspective, there are certain obstacles to effective implementation of global regulatory reforms, such as uneven pace of implementation and inconsistencies across national rules.
- Further cross-border cooperation is needed to overcome these obstacles, particularly for the successful implementation of OTC derivatives reforms and effective resolution regimes.

OTC derivatives

- A significant proportion of OTC derivatives transactions are cross-border in nature. For example, according to the BIS 2013 Triennial Survey, about half of the daily turnover in single currency interest rate derivatives contracts in FSB jurisdictions is cross-jurisdictional.
- Inconsistencies and gaps in cross-border rules can result in duplicative or overlapping regulations, or opportunities for regulatory arbitrage.
- Although some progress has been made to resolve these challenges, **further work is needed to enable regulators to defer to each other in a manner consistent with the G20 Leaders' call.**[1]

Resolution

- Effective resolution planning and the orderly resolution of a cross-border bank require national authorities to have legal powers and efficient processes for sharing information, to have developed firm-specific cross-border cooperation agreements (COAGs) for G-SIFIs, and to be able to give prompt effect to foreign resolution actions.
- These processes and powers are currently not available in most FSB jurisdictions, and they need to be addressed in order to end too-big-to-fail. **Jurisdictions should ensure that their legal regimes are aligned with the FSB guidance on information sharing for resolution purposes, that COAGs cover cooperation and information sharing in planning and carrying out a resolution, and that the FSB's final guidance on cross-border recognition is adopted.**

II. Supporting and extending implementation and monitoring work

- With more reforms coming online, there are greater demands on a limited pool of official sector resources available for domestic implementation and for monitoring by international bodies. **It is important that national authorities are adequately resourced for full and timely implementation of reforms as well as for supporting their effective monitoring.**
- To reduce overlapping demands and to assist in the effective prioritisation of monitoring efforts, the FSB in collaboration with other monitoring bodies will develop a 'heat map' of resources required for upcoming monitoring work.
- As jurisdictions implement these reforms, there will be a need to assess the consistency and effectiveness of implementation. This work is complex, resource intensive and often qualitative. Additional effort is needed to harmonise definitions and concepts across reform areas.
- The FSB will work with monitoring bodies on ways to measure and report on the consistency and effects of reforms in priority areas.

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[1] The G20 Leaders at the September 2013 St Petersburg Summit agreed that "jurisdictions and regulators should be able to defer to each other when it is justified by the quality of their respective regulatory and enforcement regimes, based on similar outcomes, in a non-discriminatory way, paying due respect to home country regulatory regimes."

Annex: Timeliness of implementation of reforms in priority areas by FSB jurisdiction

Reform Area	Basel III		OTC Derivatives (Implementing Regulations)				Resolution#		Compensation
	Risk-based capital	Liquidity coverage ratio*	Trade reporting	Central clearing	Exchange / Platform trading	Margin	Bank resolution powers	Recovery and resolution planning for systemic banks	
Agreed phase-in (completed) date	*2013 (2019)*	*2015 (2019)*	*end-2012*	*end-2012*	*end-2012*	*end-2015 (2019)*	*end-2015*	*end-2015*	
Argentina									△
Australia	✓		△					1	
Brazil	✓								△
Canada	✓		△						
China	✓								△
France									
Germany									
Hong Kong	△		△					1	
India				△		△			△
Indonesia			△		△				
Italy								2	
Japan	✓ △								
Mexico	△							1	
Netherlands									
Rep. of Korea				△					
Russia	△		△					1	△
Saudi Arabia						△			
Singapore	✓		△						
South Africa									△
Spain								2	
Switzerland	✓		△						△
Turkey									
United Kingdom									
United States			△	△	△				△

Legend

	• **Basel III:** Final rule in force (for LCR, final rule in force or will come into force on 1 January 2015). • **OTC derivatives:** Final regulations fully effective. • **Resolution:** Element of resolution regime in the FSB *Key Attributes for Effective Resolution Regimes* that is implemented / in place. • **Compensation:** All FSB *Principles* and *Standards for Sound Compensation Practices* implemented.
△	• **Basel III:** Final risk-based capital rule in force, although certain elements (e.g. capital buffers) are not yet finalised. • **OTC derivatives:** Final regulations partially effective (in force and operative for only part of the market). • **Compensation:** All except a few (3 or less) FSB *Principles* and *Standards for Sound Compensation Practices* implemented.
	• **Basel III:** Draft regulation published. • **OTC derivatives:** Implementing regulations (i) adopted but not effective; (ii) partially adopted but not effective; or (iii) in consultation or proposed. • **Resolution:** Element of resolution regime in the FSB *Key Attributes for Effective Resolution Regimes* that is partially implemented / in place. • **Compensation:** FSB *Principles* and *Standards for Sound Compensation Practices* partly implemented (more than 3 *Principles* and/or *Standards* have not yet been implemented)
	• **Basel III:** Draft regulation not published (light red colour indicates that deadline for reform has not lapsed). • **OTC derivatives:** Draft implementing regulations not yet published (dark red colour indicates that deadline for reform has lapsed). • **Resolution:** Element of resolution regime in the FSB *Key Attributes for Effective Resolution Regimes* that is not implemented / in place (light red colour indicates that deadline for reform has not lapsed).
✓	• Basel III Regulatory Consistency Assessment Program (RCAP) – assessed compliant with Basel III rules
*	**Basel III**: • The updated status of LCR implementation for Japan and Mexico is based on self-reporting since the last BCBS progress report (below), and will be reviewed by the BCBS in its next update in April 2015. • The European Commission adopted on 10 October 2014 a delegated act setting out the final details to implement the LCR for all EU banks. This delegated act will enter into force at the beginning of 2015, after the deadline set for any objection by the European Parliament and the Council ends.
#	**Resolution**: • The status of implementation for FSB jurisdictions that are EU member states will change on national transposition of the Bank Recovery and Resolution Directive. The deadline for transposition is 31 December 2014.
1	• Jurisdiction reports developing only recovery plans for systemic banks at present.
2	• Jurisdiction reports developing recovery and resolution only for G-SIB(s) at present, and not for other domestically incorporated banks that could be systemically significant.

Notes and Sources

The table above provides a snapshot of the status of implementation progress by FSB jurisdiction and priority reform area. *The colours indicate the timeliness of implementation of a particular reform as reported by each jurisdiction, and not the extent to which such implementation is consistent with the international standard.* Information within the dashboard has been collected by various monitoring mechanisms based on reporting by national authorities. It has been extracted from the following reports:

- Triennial Central Bank Survey of foreign exchange and derivatives market activity, December 2013 (BIS)
- Seventh progress report on adoption of the Basel regulatory framework, October 2014 (BCBS)
- RCAP jurisdiction-level assessments of final Basel III regulations (BCBS)
- OTC Derivatives Markets Reforms: Eighth Progress Report on Implementation, November 2014 (FSB)
- Resolution progress report to the G20, November 2014 (FSB)
- Third progress report on compensation practices, November 2014 (FSB)
- Global Shadow Banking Monitoring Report, October 2014 (FSB)