



To G20 Finance Ministers and Central Bank Governors

The global financial system continues to face a challenging outlook. With most major economies having transitioned out of a low interest rate environment amid ongoing inflation concerns, the prospect of more muted economic growth and further bouts of financial market volatility looms large.

The recent banking sector turmoil was a disturbing reminder of the speed with which underlying financial system vulnerabilities can be exposed. Encouragingly, market concerns about the banking sector have begun to ease, as contagion from the severe stresses faced by certain institutions has proven to be limited. The recovery in confidence was supported by the presence of strong capital and liquidity positions within the global banking system and the decisive actions taken by authorities in Switzerland, the United States and other jurisdictions.

Nevertheless, this episode provides important lessons. Firstly, it has underscored the importance of banks' own risk management practices and governance arrangements, as well as strong and effective supervision. The FSB and other standard setting bodies (SSBs) are working together closely to draw out lessons from the episode along with the associated policy implications. To do so, the FSB work programme has been reprioritised, including with an additional focus on the interactions between interest rate and liquidity risk across the financial system, the role of technology and social media in deposit runs, and lessons for the effective implementation of the international resolution framework. Our work to enhance the resilience of non-bank financial intermediation (NBFIs) remains as important as before. The near-term reprioritisation will yield new insights across both banks and non-banks. At the same time, we are continuing to deliver on our previously agreed body of work to the G20. The sections that follow discuss our deliverables to the July G20 meeting.

Crypto-asset markets and activities

Crypto-asset activities are borderless in nature and involve many of the same functions and risks as traditional financial activities, which makes international consistency in the application of regulatory and supervisory frameworks crucial. The FSB was therefore tasked by the G20 to promote cooperation among jurisdictional financial authorities and SSBs to ensure that crypto-asset activities are subject to robust regulation and supervision commensurate to the financial stability risks they pose, while still supporting responsible innovation. The bankruptcy of FTX and other high-profile failures in crypto-asset markets over the past year have laid bare the range of vulnerabilities within this ecosystem. Developing a global regulatory framework to address these vulnerabilities has been a key priority of the FSB.

I am therefore pleased to deliver to the G20 our finalised recommendations for the regulation, supervision and oversight both of crypto-assets and markets and of global stablecoin (GSC)

arrangements. These recommendations seek to promote comprehensive and consistent global regulatory and supervisory approaches to both types of assets. They are built on the principle of “same activity, same risk, same regulation” to support a level playing field and ensure a technology-neutral approach.

The publication of these recommendations is an important milestone. Attention must now turn to full and effective implementation of the recommendations globally. We will review the status of FSB member jurisdictions’ implementation by end-2025. We must avoid a globally fragmented system of regulation that would allow crypto-asset activities to flow to the areas where regulation is less stringent. This will require a further strengthening of cross-border cooperation and information sharing.

The FSB has been working closely with the SSBs to ensure that the work under way on the monitoring and regulation of crypto-asset activities and markets is coordinated and mutually supportive. The reports that we have sent you include a shared workplan that the FSB and the SSBs have developed for 2023 and beyond, through which we will continue to coordinate work.

The rise of crypto-assets has brought a broader set of macroeconomic policy issues to the fore. To provide a coordinated and comprehensive policy approach to these issues, the FSB will deliver to G20 Leaders a joint paper with the International Monetary Fund (IMF) in September. The paper will synthesise the policy findings from IMF work on macroeconomic and monetary issues and FSB work on supervisory and regulatory issues. Later this year, we will explore how to address the cross-border risks specific to emerging market and developing economies posed by GSCs.

Non-bank financial intermediation (NBFI)

Events in recent years have continued to underscore the importance of the FSB’s work programme to enhance resilience in the non-bank sector. A key element of that programme is policy work to address vulnerabilities from liquidity mismatch in open-ended funds. In March 2020, many of these funds experienced liquidity pressure and valuation challenges, amid large redemption requests triggered by the flight to safety. In response to these large redemptions, some open-ended funds sold assets into markets with deteriorating liquidity, thereby contributing to broader selling pressure.

For this meeting, we are delivering a consultation report on proposals to strengthen our 2017 recommendations in relation to open-ended funds, informed by lessons learned from recent events. The goal of the revised Recommendations, combined with the new IOSCO guidance on anti-dilution liquidity management tools, is a significant strengthening of liquidity management by open-ended fund managers compared to current practices. The revisions aim to clarify the redemption terms funds should offer based on the underlying liquidity of the assets they are holding and to encourage greater inclusion and use of anti-dilution tools so as to ensure the full costs of redemptions are borne by redeeming investors.

Another key element of the NBFI work programme is to assess and address vulnerabilities associated with leverage in NBFI. To this end, we will deliver a report to the G20 in September that examines NBFI leverage trends in FSB member jurisdictions and associated financial stability risks, as a precursor to launching policy work in this area. We are also undertaking

policy work to enhance market participants' liquidity preparedness for margin and collateral calls in centrally and non-centrally cleared markets in order to reduce procyclical behaviour during times of market-wide stress. This forms part of a wider set of initiatives, including work by the SSBs, to address the impact that spikes in margin requirements can have. Finally, we are conducting a peer review to take stock of the measures adopted by FSB member jurisdictions to enhance money market fund resilience in response to the 2021 FSB policy proposals.

We will send a progress report on enhancing the resilience of the NBFIs sector to G20 Leaders in September, which will include an updated programme for future work.

Operational resilience

Financial institutions' increased reliance on third-party service providers for a range of services, including some critical operations, has been propelled by digitalisation of the financial services sector. These dependencies can bring benefits to financial institutions, such as flexibility, innovation and improved operational resilience. But if not properly managed, disruption to critical services or service providers could pose risks to financial institutions and the financial system as a whole.

In June, we issued for consultation a policy toolkit that aims to reduce fragmentation in regulatory and supervisory approaches across jurisdictions and sectors and strengthen financial institutions' ability to manage third-party risks. The toolkit will be highlighted at the July G20 meeting during a panel discussion on policy issues relating to third-party risk management. We will publish a finalised toolkit before the end of the year

Climate-related risks

There is a growing focus on the risks that climate change could pose to financial stability. Two years ago, the FSB developed a Roadmap to address climate-related financial risks. Since then, progress has been steady across all four blocks of the Roadmap: data, disclosures, vulnerabilities analysis and supervisory and regulatory approaches. The FSB welcomes the recent publication of the International Sustainability Standards Board (ISSB)'s final standards, which will serve as a global framework for sustainability disclosures and, when implemented, will enable disclosures by different companies around the world to be made on a common basis. The FSB will work with the ISSB, IOSCO and other relevant bodies to promote the timely and wide use of the standards. The FSB has also been advancing work on climate-related vulnerability analysis and supervisory and regulatory approaches to climate-related risks, including the role of macroprudential policy, and will explore the potential use of corporate transition plans as a source of information to assess micro- and macroprudential risks.

While progress on the Roadmap is being made, the report delivered for this meeting highlights some areas where more attention is needed. In particular, the climate data landscape needs to be developed further – in terms of accuracy, consistency and quality – in order to support forward-looking climate risk assessments. Further work is needed to embed climate scenario analysis into the monitoring of financial vulnerabilities and to develop our understanding of the cross-border and cross-sectoral transmission of climate shocks. We are also working on developing various climate metrics to better assess how climate change can affect financial

stability, as part of our broader work to enhance the analysis and monitoring of climate-related vulnerabilities.

We have come a long way on our climate work. To reflect this progress and the work we are currently embarking upon, the FSB is delivering to the G20 an updated Roadmap.

Conclusion

The macro-financial environment has evolved rapidly in recent months. At the same time, the financial system remains in the midst of a structural evolution, which includes increasing digitalisation, growing consideration of climate-related issues and an increasingly important role for NBFIs in financing economic activity. For these structural changes to deliver benefits to society, it is crucial that associated financial risks are addressed.

Against this complex backdrop, I cannot overstate the importance of global cooperation in assessing vulnerabilities and designing and implementing policy reforms. The FSB will continue to facilitate such cooperation in the interest of enhancing global financial stability.

Yours sincerely,

A handwritten signature in blue ink that reads "Klaas Knot". The signature is written in a cursive style with a horizontal line underlining the name.

Klaas Knot