Updates on the Work on Market Fragmentation

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The G20 Leaders, in the June 2019 Osaka Declaration,[1] welcomed the work on market fragmentation, and expressed a commitment to address its unintended, negative effects, including through regulatory and supervisory cooperation. This report responds to the request of the G20 Finance Minister and Central Bank Governors for progress updates, including on ongoing work, at their meeting in October.[2]

The Financial Stability Board (FSB)'s June 2019 Report on Market Fragmentation[3] explored the link between market fragmentation and financial stability, studied the effects of supervisory and regulatory policies on market fragmentation in several key areas, and discussed possible mechanisms and approaches to tackle harmful market fragmentation. It also identified four areas for further work to address market fragmentation: deference; pre-positioning of capital and liquidity; regulatory and supervisory coordination and information-sharing; and market fragmentation as part of the evaluation of reforms, starting with the "too-big-to-fail" (TBTF) evaluation. The mechanisms and approaches identified are not designed to re-open international standards, change institutional responsibilities and setups, or add unduly to administrative burdens

Since the Osaka Declaration, the FSB, in collaboration with the standard setting bodies, have identified steps to be taken in each of these four areas and in some cases has taken specific steps. The following are updates on the current plan to implement the work in the four areas as well as some steps already taken. The FSB intends to report to the G20 as more specific outcomes are achieved.

1. Deference

The International Organization of Securities Commissions (IOSCO) June 2019 Report on Market Fragmentation and Cross-Border Regulation[4] noted that deference[5] between regulators has increased significantly and novel ways to improve cooperation have developed. At the same time, the Report recognised that several challenges remain. In this respect, IOSCO proposed several practical steps that could strengthen cooperation between regulatory authorities and further assist regulators in addressing the adverse effects of market fragmentation.

The Report proposed several measures to strengthen cooperation between IOSCO members and, in doing so, mitigate the risk of future fragmentation. These measures included proposals for:

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1 See https://www.g20.org/en/documents/final_g20_osaka_leaders_declaration.html.

2 https://www.mof.go.jp/english/international_policy/convention/g20/communique.htm.

3 https://www.fsb.org/wp-content/uploads/P040619-2.pdf

4 https://www.iosco.org/library/pubdocs/pdf/IOSCOPD629.pdf.

5 The term "deference" is used in the IOSCO Report as an overarching concept to describe reliance that authorities place on one another when carrying out regulation or supervision of participants operating cross-border. The term is used in a generic manner and is not intended to refer to the legal framework of any individual jurisdiction.

(i) fostering mutual understanding of one another's legislative framework and regular monitoring of emerging issues of market fragmentation in securities and derivatives markets;

(ii) seeking ways to deepen existing regulatory and supervisory frameworks, including through exploring whether and how existing supervisory colleges and other mechanisms of cooperation currently achieve their objectives and, if appropriate, identifying ways to increase their use; and

(iii) identifying good or sound practices with respect to deference and associated tools (e.g. passporting, recognition, substituted compliance).

The IOSCO Board will consider whether and how to take these proposals forward at its October 2019 meeting. If the proposals also consider deference relating to financial market infrastructures, this aspect of the work would be conducted jointly with the Committee on Payments and Market Infrastructures where appropriate. To bring in considerations relevant to the FSB's mandate, these bodies would cooperate with the FSB. In the meantime, IOSCO is also developing a repository for deference assessments, which will include, once completed, the deference assessments that have been conducted by member jurisdictions as well as their final outcome.

2. Pre-positioning of capital and liquidity

The FSB Report on Market Fragmentation stated the need for authorities to strengthen their understanding of approaches in home and host jurisdictions towards pre-positioning. The FSB has taken forward work on this issue through the review of the technical implementation of its Total Loss-Absorbing Capacity (TLAC) Standard, completed in July 2019, and through a workshop on prepositioning and ring fencing with external stakeholders.[6]

The TLAC standard and guidelines on internal TLAC include a requirement that a proportion of TLAC resources be pre-positioned at material subgroups in host jurisdictions. The aim is to achieve an appropriate distribution of loss-absorbing and recapitalisation capacity within global systemically important banks (G-SIBs) and thereby provide home and host authorities and the market with confidence that G-SIBs can be resolved in an orderly manner.

The review concluded that the implementation of the TLAC standard has been instrumental in enhancing the resolvability of G-SIBs, strengthening cooperation between home and host authorities and boosting market confidence in authorities' capabilities to address TBTF risks. However, the review also concluded that, as implementation is still ongoing, continued efforts may be needed to avoid potential risks of unnecessary fragmentation of capital resources as a result of implementation. It identified a set of actions, which include a stock-take of the range of practices of authorities and crisis management groups in implementing the TLAC standard and address any identified technical issues (considering, as appropriate, if any further guidance is needed).

[6] https://www.fsb.org/wp-content/uploads/P020719.pdf.

The FSB held a workshop on 26 September 2019 in Philadelphia to engage with industry representatives, academics, and other stakeholders to explore the impact of those requirements on the funding practices, capital structure, and organisation of large, internationally-active financial institutions and the way they conduct their business. Workshop participants reflected on possible approaches taken by authorities and financial institutions to ensure sufficient pre-positioning of resources while reducing incentives for disproportionate pre-positioning, and to provide incentives for greater coordination in times of stress. These include approaches to: improve cross-border supervisory and regulatory cooperation; generate and share better information to give comfort to both home and host authorities; and effectively deploy resources, which are held elsewhere in the group, where they are needed in stress. Further work will continue on these issues, including going-concern requirements and those related to resolution.

3. Regulatory and supervisory coordination and information-sharing

The FSB Report also highlighted the role of enhanced regulatory and supervisory coordination and information sharing in avoiding future fragmentation, and that the FSB and standard setting bodies could act as fora for discussions among members about planned national regulatory initiatives.

The FSB will reinforce its role as a forum for the forward-looking discussion of regulatory and supervisory initiatives with cross-border relevance. It will establish a structured process for members to gain an understanding of the relevant supervisory and regulatory policy proposals as well as to discuss issues with respect to the interaction of those policies on a voluntary and non-binding basis. This will include consideration of regulatory and supervisory policies at the development stage.

The FSB is also exploring the establishment of a repository that provides information on regulatory initiatives that could have a cross-border relevance. The FSB will discuss the detailed arrangements for such a repository in early 2020.

The FSB is also considering other approaches to avoid future fragmentation. These include the possibility to promote greater use of common elements in the reporting of supervisory data.

4. Too-Big-To-Fail (TBTF) Evaluation

The FSB's TBTF Evaluation is assessing whether TBTF reforms aimed at reducing the systemic and moral hazard risks associated with systemically important banks are achieving their intended objectives. In this context, it will also examine the broader effects of TBTF reforms (positive or negative) on the financial system, including market fragmentation. Building on the FSB's resolution work including the TLAC review,[7] the evaluation will explore whether and how resolution reforms (including TLAC) affect G-SIBs' cross-border presence and management of capital resources for home and host jurisdictions, and what the implications may be for financial stability.

7 https://www.fsb.org/2019/07/review-of-the-technical-implementation-of-the-total-loss-absorbing-capacity-tlac-standard/.

The FSB has conducted stakeholder outreach through workshops to exchange views with relevant stakeholders on this topic and through a call for public feedback.[8] A draft evaluation report will be issued for public consultation in June 2020. The final report will be published in late 2020.

8 https://www.fsb.org/2019/05/fsb-launches-evaluation-of-too-big-to-fail-reforms-and-invites-feedback-from-stakeholders/