FSB FINANCIAL STABILITY BOARD

THE CHAIR

To G20 Finance Ministers and Central Bank Governors

As we meet in Rio de Janeiro, concerns over the outlook for global financial stability are gradually abating. While the memory of past turmoil fades and optimism over a soft landing for the global economy grows, it is important to emphasise that tail risks remain. Indeed, key underlying financial system vulnerabilities have not gone away, so we must maintain our focus on building resilience.

Several areas of concern deserve our continuing attention. For one, debt levels of both government and private sector borrowers are historically high. Debt servicing pressures could increase further in a high-for-long interest rate environment, or if economic growth falters. In this context, real estate market vulnerabilities bear close monitoring, including elevated residential property prices in some jurisdictions and broad-based pressures on commercial real estate amid changing market dynamics. Second, vulnerabilities in non-bank financial intermediation (NBFI), including pockets of hidden or excessive leverage, remain a potential source of systemic risk. Combined with rich asset valuations in some markets, these vulnerabilities raise the potential for sharp price corrections in the event of a shock. Such shocks could be more likely amid heightened geopolitical uncertainty, which highlights the importance of enhancing international collaboration.

Most emerging market and developing economies (EMDEs) have exhibited remarkable resilience to date, but this could be tested by divergence in global monetary policies. A separate concern relates to possible further use of foreign currency pegged stablecoins, which may exacerbate challenges for monetary policy and capital flow management in some EMDEs. The FSB will publish in July a report discussing regulatory and supervisory issues of stablecoin arrangements in EMDEs. To help address these issues, jurisdictions should prioritise full and timely implementation of the FSB's recommendations for global stablecoin arrangements issued last year. More generally, implementation of the FSB's global regulatory framework for crypto-asset activities, including beyond the G20 membership, remains crucial for containing the cross-border financial risks posed by these assets.

In my letter to you in February, I described the FSB's overall work programme for 2024 and the reports that we will provide to the G20. In the following sections of this letter, I will elaborate on the two reports that the FSB is delivering to the July G20 meeting.

Non-bank financial intermediation

Recent incidents of market stress and liquidity strains have demonstrated that NBFI can create or amplify systemic risk. Many of the underlying vulnerabilities that contributed to these incidents are still largely in place, leaving the global financial system susceptible to further shocks. While some progress has been made to date, the pace of implementation of agreed

NBFI policies (e.g. money market reforms) has been uneven across jurisdictions and we may already be losing momentum.

To enhance the resilience of the global financial system, it is critical that we finalise NBFI reforms and strongly commit ourselves to full and timely implementation. One important goal of these reforms is to ensure that market participants better internalise their liquidity risk and thereby reduce reliance on extraordinary interventions by central banks and other public authorities during times of stress, while also better preparing authorities for future stress events.

Addressing leverage-related vulnerabilities in NBFI is another important aspect of our work to promote financial stability. Non-bank entities have been taking on additional leverage through off-balance sheet exposures, which have grown significantly over the past decade. An ambitious policy approach is necessary to mitigate the financial stability risks associated with leverage. To this end, the FSB expects to publish by the end of 2024 a consultation report with proposed policy solutions.

For this meeting, we are delivering a progress report on our work programme to enhance the resilience of the NBFI sector. The report discusses ongoing policy initiatives, including proposals by the FSB and standard-setting bodies to enhance margining practices and the liquidity preparedness of non-bank market participants for margin and collateral calls. The report also outlines further work that will help the FSB determine in due course whether collectively the reforms (once implemented by jurisdictions) have been sufficient to address systemic risk in NBFI, including where there are gaps that require further policy action.

Progress in the design and implementation of NBFI policies is hampered by a number of data challenges and the FSB is actively working to assist authorities in this regard. Overcoming data challenges is crucial for a comprehensive assessment of NBFI vulnerabilities and the formulation of effective policy responses. The FSB will continue its efforts to find ways to address the most salient data challenges in order to enhance the monitoring and regulation of the NBFI sector.

Nature-related risks

Deepening work on sustainability-related risks is a priority for the Brazilian G20 Presidency. As a contribution to this priority, we are delivering a stocktake of regulatory and supervisory initiatives on the identification and assessment of nature-related financial risks. This report also enquires into the perceptions of central banks and supervisors on whether nature degradation, such as biodiversity loss, is a relevant financial risk.

The FSB stocktake highlights that the financial authorities who participated are at different stages in evaluating the significance of nature-related risks as financial risks, and their approaches also differ according to their differing mandates. While some have conducted analytical work and concluded that nature-related risks are material financial risks, others are still at the earlier stage of monitoring international developments on this topic and a few authorities have decided not to work on the topic. All those currently embarking on analytical work recognise the major data and modelling challenges involved. Some authorities have initiated regulatory and supervisory initiatives to address these risks, including promoting firmlevel disclosures of nature-related risks as a crucial aspect of risk management. There is a recognition among financial authorities that more expertise is required in the supervisory community, in central banks, and in the private sector to understand and, where needed, address nature-related financial risks. A number of capacity building initiatives are already underway to enhance knowledge and capabilities in this area. Some financial authorities also are conscious that this is not a subject on which they can act alone; their work needs to be seen within the context of society's overall strategy to address nature degradation.

Conclusion

In this uncertain environment, it is important to remain ambitious in our work to promote financial stability and to follow each strand of work through to completion. That includes full implementation of agreed reforms, for which I welcome the ongoing support of the G20. Financial crises are too costly to tolerate the persistence of vulnerabilities that authorities have already identified and agreed to address.

Underpinning the FSB's work is an appreciation for the myriad cross-border and cross-sectoral interconnections that characterise the international financial system. These linkages are stronger than ever, which calls for similarly strong cooperation among authorities. The FSB will continue to foster this cooperation in the interest of a resilient, well-functioning global financial system that can facilitate strong, sustainable, balanced and inclusive growth.

Yours sincerely,

Klaas Knot