Taking a system-wide perspective: the key to financial resilience

Although COVID-19 sent shockwaves throughout global financial markets, financial crisis reforms lessened the severity. However, there is more that the FSB can do

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The global financial system has so far weathered the real-life stress test presented by COVID-19. Extraordinary policy actions played a key role in maintaining confidence. Thanks to these actions and the G20 financial regulatory reforms brought in following the 2008 crisis, the banking sector was able to absorb rather than amplify the shock. Central counterparties largely performed as intended, and markets continued to operate effectively in spite of prolonged remote working arrangements. Indeed, those parts of the global financial system where implementation of post-crisis reforms is most advanced displayed the greatest resilience. This underlines the financial stability benefits of the full, timely and consistent implementation of agreed reforms.

ENHANCING RESILIENCE

Nevertheless, the financial market turmoil that occurred in March 2020 revealed vulnerabilities in parts of the financial system, notably non-bank financial intermediation, that need

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to be addressed urgently. The turmoil highlighted issues associated with particular market activities and mechanisms that may have caused liquidity imbalances and propagated stress. It also highlighted the increased importance of interconnectedness – both within the NBFI sector and with banks – for the resilience of the financial system.

The Financial Stability Board is taking forward a comprehensive work programme to enhance the resilience of the NBFI sector while preserving its benefits. The diverse nature and complexity of NBFI, as well as its links with the banking sector and the real economy, raise new challenges for the assessment of resilience, given that different parts of the financial system may interact in unexpected ways and amplify or dampen shocks. Our efforts, therefore, focus on three main areas: analytical and policy work on specific issues, in particular the dependence of the sector on readily available liquidity; developing a systemic perspective on risks in NBFI; and policies to address such systemic risks.

The work conducted so far has largely been in specific areas. The focus now is to deepen our understanding of systemic risk in NBFI and develop policies to address this risk where appropriate. Efforts to strengthen NBFI resilience should not compromise the resilience of other parts of the system or the important role that NBFI plays in financing the real economy. The work is being carried out within the FSB as well as by its member standard-setting bodies and international organisations to ensure that relevant experiences and perspectives are incorporated.

A HOLISTIC FRAMEWORK

COVID-19 served as a reminder that a shock originating outside the financial system may test the stability of the global financial system. This underlines the importance of vigilant monitoring to identify and address new and emerging risks to financial stability early on. In keeping with its surveillance mandate, the FSB recently revised its financial stability surveillance framework. The new framework aims to reinforce the FSB's capacity to identify vulnerabilities in a proactive and forward-looking manner. It is based on systematic analysis that spans all parts of the global financial system. To serve the international remit of the FSB, the new framework provides a global, cross-border and cross-sectoral perspective on current vulnerabilities. It does so by drawing on the collective perspective of the FSB's broad membership.

The framework focuses on vulnerabilities – the accumulation of imbalances in the financial system – as opposed to the shocks that may trigger those vulnerabilities. This approach reflects a recognition that policy action can and should focus on containing the build-up of vulnerabilities rather than try to anticipate shocks. It also emphasises vulnerabilities that are common across countries or that may engender cross-border spillovers, which could interact with other vulnerabilities.

Over the past year, the FSB has fostered cooperation and coordination by analysing and responding to rapidly unfolding events, working to stabilise the financial system and the provision of finance amid great uncertainty, and assessing the impact of our collective actions. These strengths will continue to guide us going forward. As we progress towards a post–COVID-19 world, FSB members will continue to work together, leveraging our collective powers to address current and evolving priorities and promote global financial stability in the face of new challenges. G20

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Randal K Quarles became chair of the Financial Stability Board in 2018. He has been a member of the Board of Governors and vice chair for supervision of the Federal Reserve System since 2017. Previously, he founded and was managing director of the Cynosure Group and a partner at The Carlyle Group. Quarles served as under secretary for domestic finance at the US Treasury and as assistant secretary for international affairs. He also served as the US executive director of the International Monetary Fund.

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