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Cooperation for the common good

Federal Reserve Bank of San Francisco and Monetary Authority of Singapore (MAS) Symposium on Asian Banking and Finance

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Remarks by Dietrich Domanski, Secretary General, Financial Stability Board[1]

I would like to thank the Monetary Authority of Singapore and the Federal Reserve Bank of San Francisco for the invitation to speak at today's Symposium. During the past twelve years, this conference has been an important forum for discussing current issues in global banking and finance. In this vein, I would like to offer some observations on the evolving risk backdrop, on global financial resilience, and on the role of international cooperation going forward.

Evolving risks

My first observation concerns the evolving nature of financial stability risks. That risks change is neither new nor surprising – in fact, it is what one would expect in a dynamic global financial system. But it calls for continuous monitoring and assessment of changes in financial markets and institutions by financial stability authorities. At the current juncture, this calls in particular for efforts to understand the financial stability implications of major post-crisis trends in credit markets.

The first trend is the rise in global non-financial sector indebtedness over the past decade. Non-financial sector corporate debt, in particular, stands now at above 90% of GDP globally, about 15 percentage points higher than in 2008. Much of this increase is attributable to increased borrowing by emerging market corporates. At the same time borrowers have become more risky, with BBB-rated bonds now making up about half of the outstanding investment grade market in major advanced economies.

The second trend is a shift in the global patterns of financial intermediation. The role of banks has declined relative to that of non-banks. The FSB's latest *Global Monitoring Report on Non-Bank Financial Intermediation*[2] shows that, by end-2017, financing extended by non-banks accounted for almost half of all financial assets globally. To be sure, greater non-bank financial intermediation adds welcome diversity to the provision of funding. At the same time, with the growth of non-bank financial intermediation questions about the robustness of market liquidity have moved to the fore. We need to understand whether, and under what conditions, certain forms of non-bank intermediation may amplify the transmission of financial shocks, potentially including through spillovers from advanced markets to emerging market economies.

[1] The views expressed in this speech are those of the speaker and do not necessarily reflect those of the FSB or its members.
[2] FSB, *Global Monitoring Report on Non-Bank Financial Intermediation*, February 2019

Global financial resilience

In light of these trends, what can we say about the resilience of the global financial system? The press release on the latest FSB Plenary meeting on 26 April in New York states: "The core of the financial system is considerably more resilient than it was a decade ago. Potential vulnerabilities in the financial system persist, however, and in some cases have built up further and policy space is limited".[3]

The greater resilience of the core has several aspects: the most important banks hold much more capital and have more stable funding patterns; important financial markets are more transparent; and main fault lines in securitisation markets have been addressed. However, to realise their full benefits all agreed reforms need to be implemented in a timely, comprehensive and consistent manner. The FSB will later this month update the G20 on implementation of the post-crisis reforms. Addressing remaining gaps remains a priority.

At the same time, there are questions as to the extent of financial institutions' exposures to riskier credit instruments, including leveraged loans, directly and through collateralised loan obligations (CLOs). While CLO structures appear to be more robust now than before the global financial crisis, leveraged loan credit quality has deteriorated over the past few years and it remains unclear whether CLO prices are aligned with risk. The FSB is closely monitoring these markets and members will further examine information on the pattern of exposures to these assets in the coming months.

The role of global cooperation

Let me conclude with a couple of points on the role of global cooperation.

In the aftermath of the crisis, the G20-led financial reforms were essential to mend the fault lines that led to the crisis. Unprecedented international cooperation was instrumental in building a resilient global financial system while preserving its open and integrated structure

Going forward, identifying and addressing new vulnerabilities early on will be key for reinforcing resilience. To this end, the FSB is strengthening its regular monitoring of financial stability risks. The FSB has embarked on the development of a new framework to support the comprehensive, methodical and disciplined review of potential vulnerabilities in the global financial system.

Being forward looking also means analysing the potential financial stability implications – positive and negative – of major structural changes in the financial system. This includes the shift to non-bank financial intermediation mentioned before. It also includes assessing the effects of technological innovation. One current example of such work is a report on the financial stability implications of decentralised financial technologies that we will be publishing this Thursday.

[3] FSB, *FSB Plenary meets in New York*, April 2019

Many of these conjunctural and structural developments are of a global nature or have important cross-border aspects. Close international cooperation on financial stability policy remains therefore as important today as it was during the past decade.