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COVID-19: a watershed for the FSB's work agenda

Launch of the International Regulatory Strategy Group report *'Global Solutions to Global Problems: Promoting Regulatory Coherence in Financial Services for Pandemic Recovery'*

18 March 2021

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

Thank you for the invitation to be with you today. This is a timely event, coming almost a year to the day that global equity markets experienced the worst drop since Black Monday in 1987, triggered by the epic shock of the COVID-19 pandemic. Since then, the pandemic has fundamentally altered our lives, at a very personal level as well as professionally.

COVID-19 has also marked a watershed in the work of the Financial Stability Board. As the first serious test of the resilience of the global financial system since the 2008 financial crisis, COVID-19 has provided us with a real-life assessment of the global regulatory framework put in place after 2008 and of international cooperation on financial stability through the FSB.

I would like to elaborate on what this watershed means for the FSB's work in 2021 and beyond. I'll focus on three themes: first, the need to address the lessons learned from COVID-19 for financial stability; second, the need to harness the benefits of innovation to support a strong and sustainable recovery from the pandemic; and third, the importance of global cooperation, not least to preserve an integrated global financial system.

Addressing the lessons learned from COVID-19 for financial stability

To an important extent, this greater resilience is due to the regulatory reforms enacted post 2008. The Basel III framework, the shift to mandatory central clearing, and steps taken to end too-big-to-fail have all helped to make the core of the global financial system more resilient.

At the same time, the market turmoil last March has underscored the need to strengthen resilience in non-bank financial intermediation, or NBFI. With the overall growth of NBFI – due to market driven adjustments and the G20 regulatory reforms – market liquidity has become more central to financial resilience. Last March, the 'dash for cash' resulted in liquidity

[1] The views expressed in these remarks are those of the speaker and do not necessarily reflect those of the FSB or its members.

mismatches that overwhelmed key funding markets. Public authorities needed to take a wide range of measures to support liquidity and the supply of credit to the real economy.

These developments define the key areas of a very active FSB policy work agenda for 2021:

The first is to draw lessons from COVID-19 for financial stability, including whether the reforms the G20 put in place following the 2008 financial crisis are working as intended, and where they may not be. We will look at the use of capital and liquidity buffers by financial institutions, and how well crisis management and operational resilience arrangements have functioned. This work will also examine whether and how procyclicality has affected the financial system. We will work on these issues in coordination with standard-setting bodies (SSBs), and provide the G20 with an interim report on initial lessons learned in July and a final report in October. Any lessons learned at this stage will be preliminary, but it is important for us to critically assess our actions.

The second area is CCP financial resources. Recent periods of market turmoil have further demonstrated the positive effect that central clearing can offer for global financial stability. However, the shift to central clearing has also further increased the systemic importance of central counterparties, as we knew it would. To this end, the FSB will collaborate with the Committee on Payments and Market Infrastructures and International Organization of Securities Commissions on work that will consider the need for – and develop as appropriate – international policy on the use, composition and amount of financial resources necessary to strengthen the resilience and resolvability of CCPs further, in default and non-default loss scenarios.

Last, but certainly not least, one area where we have already started to draw lessons is NBFI. We have embarked on a comprehensive and ambitious work programme to strengthen the resilience of the NBFI sector while preserving its benefits. The work programme includes: (i) work to address specific risk factors that contributed to amplification of the shock; (ii) work to enhance our understanding of systemic risks in NBFI; and (iii) investigating policies to address systemic risks in NBFI.

A key focus this year is to develop policy proposals to enhance the resilience of money market funds (MMFs). The structural vulnerabilities in some types of MMFs relate to the greater role of liquidity risk I mentioned before: liquidity mismatches in MMFs and investors' perception of these funds as being equivalent to cash. Identifying policy options to enhance MMF resilience will include consideration of the appropriate structure of the MMF sector itself and the role of potential vulnerabilities in the underlying short-term funding markets. We are working in close collaboration with SSBs and plan to publish a consultative report, with policy proposals to enhance MMF resilience, in July.

Other work will entail examining the frameworks and dynamics of margin calls, and the liquidity management preparedness of market participants to meet margin calls. It will also include examining the experience of certain types of open-ended funds that faced redemption pressures during the March turmoil;[2] the structure and liquidity provision in core funding markets during stress, including the role of leveraged investors and factors that limit dealer capacity or

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willingness to intermediate. And we will look at the interaction of US dollar funding pressures and fund outflows in emerging market economies.

Harnessing the benefits of innovation

The COVID-19 experience has put the spotlight on the need to harness the benefits of financial innovation while containing financial stability risks. Issues related to operational and cyber resilience have become even more pressing in sustained remote work environments. Similarly, limited personal mobility has underscored the need to improve cross-border payment arrangements and financial inclusion.

The most comprehensive initiative in this area is the FSB roadmap[3] designed to make cross-border payments cheaper, faster, more transparent, and more inclusive – a goal that requires strong commitment, coordination, and accountability from the international community, both public and private sectors. The G20 endorsed the roadmap last October, and one of the first steps in implementing it involves the setting of quantitative targets at the global level for improving outcomes for end-users. These targets will be important for defining the ambition of our work and for creating accountability.

We will deliver an overall progress report on the implementation of the roadmap, together with a final set of targets in October for G20 endorsement.

Innovation underpins the whole roadmap, in many cases in the form of improvements to existing payment systems. But there are also two building blocks that focus squarely on new, digital payment instruments – 'stablecoins' and central bank digital currencies. As 'stablecoins' continue to evolve, comprehensive and effective oversight of such instruments at the national and international level will be of the utmost importance. Last year, the FSB published 10 high-level recommendations on the regulation, supervision and oversight of global 'stablecoins'[4]. Building on this work, we will continue discussions of regulatory and supervisory approaches with respect to 'stablecoins', and how to underpin these with effective cross-border cooperation and coordination.

I would also like to say a word on cyber resilience. We are now turning our attention to ensuring greater harmonisation of regulatory reporting of cyber incidents. This will enable more effective monitoring of cyber incidents, support the efficient supervision of cyber risks at financial institutions, and facilitate the coordination and sharing of information relating to cyber incidents across borders and sectors.

Preserving an integrated global financial system

The policy response to COVID-19 has underlined policymakers' awareness of the harmful effects of market fragmentation and the need for international cooperation and coordination. The FSB agreed, and the G20 endorsed, a set of principles to underpin policy measures taken in response to COVID-19, and to reiterate FSB members' commitment to common international

[3] Enhancing Cross-border Payments: Stage 3 roadmap

[4] Regulation, Supervision and Oversight of "Global Stablecoin" Arrangements

standards[5]. Guided by these principles, FSB member authorities have made use of the flexibility built into existing financial standards. Authorities will also coordinate on the future timely unwinding of the temporary measures taken in order to minimise the risk of unnecessary fragmentation.

Work to prevent harmful market fragmentation also continues across a range of FSB initiatives on regulatory and supervisory policies and in the area of resolution. It is critical that we also extend the awareness to new areas, first and foremost the way we address financial risks from climate change.

Addressing issues related to climate change and supporting a sustainable recovery is a key priority of the Italian G20 Presidency. More generally, an increased sense of urgency has resulted in a proliferation of work on climate change.

The current momentum on climate-related work is very welcome, but underlines the importance of good coordination. The FSB, with its broad and diverse membership, which includes the standard-setting bodies and international organisations, is well placed to ensure that the work on the financial risks of climate change fits together. We are also working closely with the Network for Greening the Financial System on our common goals.

The FSB currently has three specific initiatives underway to coordinate work on climate – on data, on disclosures, and on regulatory and supervisory practices. The FSB has been asked by the G20 to report, in July, on ways to promote consistent, high-quality climate disclosures that are in line with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), and on the data necessary for the assessment of financial stability risks and where data gaps remain.

Conclusion

Let me conclude. I have focused on the changes that COVID-19 is bringing about to the work of the FSB. But, equally, I could have talked about the importance of continuity in our work. This includes continuity in our efforts to address financial stability risks identified earlier, such as ensuring a smooth transition away from LIBOR. And equally important is the continuity in the way we work. Our collaborative, member-led approach, together with close interaction with external stakeholders, continues to provide the basis for promoting a resilient global financial system in an effective way.

5 *COVID-19 pandemic: Financial stability implications and policy measures taken*