Cooperation: the foundation of a resilient global financial system

COVID-19 has posed the greatest challenge to the financial system since 2008. Back then, post-crisis reforms helped build up a resilient system. Now, as the economic consequences of the pandemic continue to evolve, continued cooperation is essential to maintain financial stability

Randal K Quarles, *Chair, Financial Stability Board, and Vice Chair, US Federal Reserve*

The outbreak of COVID-19 and the containment measures that governments adopted in response created an unprecedented economic shock. The financial system faced its greatest challenge since the 2008 global financial crisis and a real world stress test of the post-crisis reforms. The financial reforms that G20 leaders initiated 11 years ago have paid off. The core of the financial

system has remained resilient in the face of the huge external shock that the COVID-19 event represents. Banks entered the crisis with significantly higher capital and liquidity than they did in 2008, enabling them to absorb rather than amplify the shock. As a result, the financial system has been able to continue to support the real economy, validating the G20 leaders' vision that a more resilient financial system is better placed to serve the needs of our economies.

The Financial Stability Board has played a critical role in supporting international cooperation and coordination of the COVID-19 response. Since the onset of the COVID-19 event, FSB members have shared information, assessed vulnerabilities and coordinated policy responses. Most regulatory measures taken by FSB members used the flexibility available in international standards, including in the form of system-wide and firm-specific buffers. In April 2020, the G20 endorsed the FSB principles that guide the use of this flexibility, to preserve a level playing field and prevent harmful market fragmentation.

In response to the COVID-19 event, FSB members took swift action to stabilise markets, but the path of recovery is still uncertain. Although the FSB's initial response focused on the significant liquidity stress in financial markets and on measures to promote financing to the economy, we have increased our focus on the solvency risks to which financial institutions are exposed and on the changing assessments of the funding needs of the real economy, depending on the path of the recovery. Potential procyclical effects of credit rating downgrades and the risk of further liquidity stress require continued attention.

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LESSONS TO LEARN

The financial system has shown increased resilience, but there are still lessons to learn. For one, the COVID-19 event has underscored the need to ensure that regulatory reforms are working as intended. In June, as part of its ongoing programme of evaluations, the FSB published for consultation an evaluation of the effects of too-big-to-fail reforms. These reforms were endorsed by the G20 following the global financial crisis, and have been implemented by FSB jurisdictions over the past decade. The evaluation finds that the reforms have made systemically important banks more resilient and resolvable, thereby helping to reduce their systemic and moral hazard risks.

In addition, the market turmoil in March, which led to the need for massive intervention by central banks, has highlighted the need to better understand vulnerabilities in non-bank financial intermediation and strengthen its resilience while preserving its benefits. The growth and evolution of NBFI have been one key trend in the global financial system over the past decade. Although this may have helped to further diversify sources of credit in support of economic growth, it is essential that authorities understand any associated risks. By the G20 summit in November, the FSB will therefore carry out a holistic review of the market turmoil in March and will map the critical connections within the NBFI sector and between that sector and the banking system. This will inform the FSB's work to improve the resilience of NBFI while preserving its benefits.

As G20 leaders prepare for their November summit, they should keep in mind the significant benefits reaped from their support for global regulatory standards over the past decade. Thanks to the post-crisis reforms, the financial system has proved resilient in the face of unprecedented challenges. As the economic consequences of COVID-19 continue to evolve, continued cooperation among financial authorities will be essential in maintaining global financial stability.

RANDAL K QUARLES

Randal K Quarles became chair of the FSB in December 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. Mr 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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