FINANCIAL STABILITY BOARD

Progress in the Implementation of the G20 Recommendations for Strengthening Financial Stability

Report of the Financial Stability Board to G20 Finance Ministers and Central Bank Governors

15 February 2011

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I. Introduction

This note provides an overview of work underway to implement the G20 recommendations for strengthening financial stability. It focuses on international policy development and implementation that has taken place since the G20 Seoul Summit in November 2010.

II. Implementation of reforms to bank capital and liquidity standards

Following the endorsement by the G20 Leaders of the Basel III package of capital and liquidity reforms at the November Seoul summit, the Basel Committee issued the Basel III rules text on 16 December 2010. All members will now put in place the necessary regulations and/or legislation to implement the Basel III framework on 1 January 2013, such that it can be fully phased in by 1 January 2019.

The Committee will closely observe the impact and behaviour of the liquidity ratios, the rules for which include a review clause to address any unintended consequences. The observation period will be used to monitor the impact of the standards on smaller institutions versus larger ones, and on different business lines, especially focusing on the impact on retail versus wholesale business activities; the observation period for the Liquidity Coverage ratio began on 1 January 2011. Final changes to the Liquidity Coverage Ratio (LCR) would be made by mid-2013 and to the Net Stable Funding Ratio (NSFR) by mid-2016. The LCR, including any revisions, will be introduced on 1 January 2015. The NSFR, including any revisions, will move to a minimum standard by 1 January 2018.

Basel III also includes a simple leverage ratio, the transition period for which began on 1 January 2011 and includes a supervisory monitoring period and a parallel run period. The supervisory monitoring period will focus on developing templates to track in a consistent manner the underlying components of the agreed definition and resulting ratio. The parallel run period commences on 1 January 2013 and runs until 1 January 2017. During this parallel run period, the Committee will assess whether the proposed design and calibration of the minimum Tier 1 leverage ratio of 3% is appropriate over a full credit cycle and for different types of business models. Bank level disclosures of the leverage ratio and its components will start on 1 January 2015. Based on the results of the parallel run period, any final adjustments to the definition and calibration of the leverage ratio will be carried out in the first half of 2017, with a view to migrating to a Pillar 1 treatment on 1 January 2018 based on appropriate review and calibration.

In November 2010, the G20 recommended that the Basel Committee evaluate the impact of regulatory regimes on trade finance, with an emphasis on low income countries. The BCBS asked its Policy Development Group to carry this work forward, in close cooperation with the

BIS. At its February meeting, the PDG invited a number of interested constituents to give a presentation on the trade finance topic. The BCBS will finalise its recommendations in this area in time for the November 2011 G20 Leaders Summit.

III. Addressing systemically important financial institutions (SIFIs)

At the November 2010 Summit, the G20 Leaders endorsed the policy framework, work processes and timelines set out in the FSB report "Reducing the moral hazard posed by systemically important financial institutions" and encouraged the FSB and standard setting bodies to complete their remaining work in accordance with the endorsed work processes and timelines in 2011 and 2012. The report set out a policy framework for addressing the moral hazard risks associated with SIFIs whose disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity. The framework combines:

- a resolution framework and other measures to ensure that all financial institutions can be resolved safely, quickly and without destabilising the financial system and exposing the taxpayer to the risk of loss;
- a requirement that SIFIs and initially in particular global SIFIs (G-SIFIs) have higher loss absorbency capacity to reflect the greater risks that these institutions pose to the global financial system;
- more intensive supervisory oversight for financial institutions which may pose systemic risk;
- robust core financial market infrastructures to reduce contagion risk from the failure of individual institutions and
- other supplementary prudential and other requirements as determined by the national authorities.

The FSB will establish a Peer Review Council within the FSB to assess national G-SIFI policy implementation. This will be based on an evaluation framework for the application and review of G-SIFI policies to be set out by the FSB, in consultation with the standard-setters, by end-2011. The initial reviews will take place at end-2012.

G-SIFI determination and loss absorbency

The BCBS is finalising its methodology to assist in determining the globally systemically important banks. The BCBS presented a provisional methodology to the FSB in December. Based on feedback from the Group of Governors and Heads of Supervision, the Committee's oversight body, and from the FSB, the Committee is amending this methodology to better capture global activities, and to strengthen the measurement of interconnectedness, substitutability and complexity. Following a data collection exercise conducted in January 2011, the methodology is currently being revised and will be reviewed by the Committee at its meeting on 8-9 March. The IAIS also provided to the FSB in January 2011 a status report on a preliminary methodology to assess systemic importance of insurers and expects to provide details of the preliminary methodology to the FSB in March. The finalised methodologies will be sent to the FSB as input to the determination by the FSB and national authorities by mid-2011 of those institutions to which the FSB G-SIFI recommendations will initially apply.

In Seoul, the G20 Leaders endorsed "a requirement that SIFIs and initially in particular financial institutions that are globally systemic (G-SIFIs) should have higher loss absorbency capacity to reflect the greater risk that the failure of these firms poses to the global financial system." The FSB, in consultation with the standard setters, will recommend the additional degree of loss absorbency and the instruments by which these can be met by end-2011. The BCBS is developing a framework to assess the magnitude of additional loss absorbency that G-SIFIs should maintain. The Committee will review this methodology at its March meeting and expects to complete its study of the magnitude of additional loss absorbency by mid-2011. The IAIS will provide input to the FSB on what measures could be applied to insurers identified as G-SIFIs, taking into account the differences in characteristics of business models between insurers and banks. Proposals for G-SIFIs' additional loss absorbency will be sent for public consultation during the second half of 2011, before the end-2011 recommendations are made.

Resolution tools and regimes

The FSB SIFI report endorsed at Seoul recommended that "All jurisdictions should undertake the necessary legal reforms to ensure that they have in place a resolution regime which would make feasible the resolution of any financial institution without taxpayer exposure to loss from solvency support while protecting vital economic functions through mechanisms which make it possible for shareholders and unsecured and uninsured creditors to absorb losses in their order of seniority."

A comprehensive work programme is underway to set out the essential features and tools that national resolution regimes for financial institutions, including non-bank financial institutions, should have to meet these objectives (Key Attributes of Effective Resolution Regimes). These will identify the essential resolution tools and powers, including: sector-specific attributes of resolution regimes that are necessary to protect depositors, policy holders and investors, as well as restructuring mechanisms, which may include contractual and/or statutory debt-equity conversion and write-down tools; critical framework conditions for effective cross-border cooperation and information sharing in managing and resolving a distressed financial institution; essential elements of institution-specific cross-border cooperation agreements; essential elements of recovery and resolution plans (RRPs); and criteria for authorities to assess the resolvability of individual institutions.

In developing these Key Attributes the FSB is drawing on sector-specific work of the BCBS, IAIS, IOSCO, IADI and further technical work that is underway, as well as the changes that are currently underway or have recently been implemented at national and regional levels. A FSB Steering Group on Resolution is coordinating this work and will prepare a draft of the Key Attributes by mid-2011 which should be finalised by the end of the year.

The BCBS Cross-Border Bank Resolution Group is conducting a survey on national resolution regimes and tools and will report the preliminary results of this stock-take in mid-2011. The objective is to assess progress against the March 2010 Recommendations on Cross-border Bank Resolution and to assess the legislative and other changes to national resolution regimes and policies needed to accomplish effective resolution of SIFIs. The IAIS adopted the

Standard on Cross-border Cooperation on Crisis Management in October 2010 and is currently developing an issues paper on resolution of cross-border insurance legal entities and groups, which it aims to complete by April 2011.

The FSB Cross-border Crisis Management Group (CBCM) is assessing progress in the work of the institution-specific Crisis Management Groups, and will formulate criteria for authorities to assess the resolvability of SIFIs and identify the essential elements for RRPs. It will present a report on its work to the FSB Plenary by mid-2011 and report on progress in the development of RRPs for G-SIFIs in Q4 2011.

An FSB Working Group on Bail-in is examining the legal and operational aspects of contractual and statutory bail-ins, as well as the marketability and other issues bearing on the viability of these instruments. Its objective is to identify the statutory framework conditions and legal procedures that would be needed for an effective implementation of statutory and contractual bail-in in the national context and in the context of cross-border group structures of SIFIs and for bail-in to serve as a loss-absorption instrument and resolution tool. The Group will present a report on its work to the FSB in Q2 2011. As the work on resolution progresses, the FSB will in the course of 2011 undertake consultations with market participants and private sector experts.

Supervisory intensity and effectiveness

Standard setters and national supervisors are addressing the recommendations of the FSB's November 2010 report on "Intensity and Effectiveness of SIFI Supervision". National banking supervisors are self-assessing their compliance with the BCBS core principles covering mandates, powers, resources and independence which create the foundation for effective supervision. The self-assessments will be sent to the FSB by June 2011.

Supervisory agencies in many countries are addressing shortcomings in their supervisory frameworks. This will be enhanced by work which is underway co-operatively between the BCBS and FSB to assess changes supervisors are making to their supervisory tools and methods.

BCBS, IAIS and IOSCO are tightening their core principles, implementation standards and assessment methodologies and criteria to provide enhanced guidance to supervisors and more support to assessors including IMF/World Bank FSAP assessments. BCBS will report on its work in this area to the FSB by end-2011.

IV. Shadow Banking

At the November 2010 Seoul Summit, in view of the completion of the new capital standards for banks (Basel III), the G20 Leaders recognised the potential for regulatory tightening to increase the incentives for business to migrate to the shadow banking system and for the need to close regulatory gaps. They requested that the FSB, in collaboration with other international standard setting bodies, develop recommendations to strengthen the regulation and oversight of 'the shadow banking system' by mid-2011.

In response to this request the FSB organised a workshop of experts hosted by the UK FSA on 6 December 2010 to exchange views on the shadow banking systems. The FSB has since formed a task force to draft a scoping paper that will (i) clarify what is meant by “the shadow banking system (SBS)”, (ii) set out potential approaches for a monitoring framework around shadow banking and (iii) develop a range of options for discussion setting out possible regulatory measures to address the issues posed by shadow banking, including the possibility for both regulation of shadow banking directly and regulation of banks’ interactions with the shadow banking system.

Based on the work of the task force, the FSB will develop initial recommendations by mid-2011 and submit recommendations to the G20 in autumn. Shadow banking is inherently complex as it mutates over time and varies across jurisdiction. The FSB will continue its work on this complex issue in the second half of 2011.

V. Improving the OTC and commodity derivatives markets

The G20 Leaders’ Declarations from the Seoul, Toronto and Pittsburgh summits, and the FSB’s recommendations, made in its October 2010 report on Implementing OTC Derivatives Market Reforms, set out actions and timelines for achieving reforms in the OTC derivatives markets. Work is now underway nationally and regionally to implement these reforms. At the Seoul Summit, the G20 also asked the FSB to consider what future work may be needed on commodities derivatives.

The FSB is monitoring the progress being made in international fora and jurisdictional implementation of reforms in the OTC derivatives market. The bodies responsible for carrying out the actions recommended by the FSB to implement reforms - CPSS and IOSCO, as well as the OTC Derivatives Supervisors Group and OTC Derivatives Regulators Forum - are providing an assessment of progress to the FSB. IOSCO recently published its analysis of exchanges and electronic platforms for derivatives trading. IOSCO and CPSS are currently drafting a report which will set out: (1) minimum data reporting requirements and standardised formats for derivatives contracts; and (2) the methodology and mechanism for the aggregation of derivatives data on a global basis. The report will cover reporting requirements for both for market participants reporting to trade repositories and for trade repositories reporting to the public and to regulators for the purpose of macro- and micro-surveillance. In addition,the CPSS and IOSCO will publish by April 2011 a consultative report on standards for financial market infrastructures, both as this relates to payment and securities settlement and to central counterparties in the OTC derivatives markets. The FSB will consider these inputs and also analyse FSB member questionnaire responses and report on international and jurisdictional implementation progress to the G20 Finance Ministers and Central Bank Governors in April.

The FSB is also considering whether further recommendations may be needed to carry out the G-20 commitments to exchange or electronic platform trading, central clearing and reporting of OTC derivatives transactions to trade repositories. One issue to be addressed is ensuring fair and open access, both direct and indirect, to OTC derivatives CCPs. As implementation progresses, inconsistencies may give rise to opportunities for regulatory arbitrage. The FSB will be vigilant in monitoring emerging risks and reporting to the G20 any areas where action needs to be taken.

Active analysis of transparency and oversight of the commodity derivatives market is also underway. A joint report of the IEA, IEF, IOSCO and OPEC on the assessment of oil spot market prices by oil price reporting agencies, and how this affects the transparency and functioning of oil markets, will be considered by the FSB and reported to G20 Finance Ministers and Central Bank Governors in April. In a separate workstream, IOSCO will develop standards of best practice for the regulation and supervision of commodity derivatives markets, taking into account recent regulatory experience in the areas of contract design and market surveillance. While this report will put particular emphasis on oil commodity markets in light of the G20's interest in this area, recommendations are expected to be of broad application to financial commodity markets, including agricultural-based contracts. The FSB will consider recommendations regarding commodity derivatives market regulation and supervision in the context of the agreed reforms to OTC derivatives markets more generally, and IOSCO will deliver a final report on supervision and regulation of commodity derivatives markets by the fall.

VI. Developing macroprudential frameworks and tools

At their meeting in Seoul in November 2010, G20 Leaders concluded that further work on macroprudential frameworks was a priority and asked the FSB, jointly with the IMF and BIS, to provide an update to the Ministers and Governors in February on progress in the development of macroprudential policy frameworks. The update that is being sent to the Ministers and Governors summarises the work underway internationally and nationally to develop effective macroprudential policies and frameworks, by drawing also on surveys conducted by the BIS and IMF. The three organisations are currently discussing the workplan for the remainder of 2011, to focus primarily on analytical challenges, on the possibility to distil from stocktaking exercises lessons for the development of policies and frameworks, on providing forums for international information sharing and cooperation. A joint FSB/IMF/BIS conference on macroprudential policy frameworks will be held in the spring. The three organizations will submit a joint progress report, outlining advances in the state of knowledge and covering both international and national developments, to G20 leaders at their November 2011 Summit.

VII. Progress towards convergence on strengthened accounting standards

At the Seoul Summit, the G20 Leaders re-emphasised the importance of achieving a single set of improved high quality global accounting standards and called on the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) to complete their convergence project by the end of 2011.

The IASB and FASB have made substantial progress toward their June 2011 target date for convergence of their key financial instruments standards while retaining target completion dates for other projects in the second half of 2011. The US SEC continues to work toward making a determination by end-2011 whether to incorporate IFRS into the financial reporting system for US issuers.

Progress toward FSB recommendations for improved, converged accounting standards is being made in four main areas.

- **Lending activities:** The FSB is particularly supportive of the development of converged standards that would not expand the use of fair value in relation to the lending activities of financial intermediaries. The IASB issued IFRS 9 in November 2009 which includes an amortised cost category for financial assets such as loans and certain investments in debt securities. While the FASB had previously proposed in May 2010 to use fair value measurement for lending activities, in January 2011 the FASB decided to develop an amortised cost category for inclusion in the final standard on financial instruments. This decision was informed by views expressed in comment letters received and during an extensive programme of investor outreach.
- **Impairment of financial assets:** The FSB recommended that the IASB and FASB incorporate a broader range of available credit information than in existing provisioning requirements, so as to improve the recognition of credit impairment and transparency to investors while also potentially helping lessen procyclicality. In January 2011, the IASB and FASB jointly issued an exposure draft proposing a converged expected loss approach for open portfolios that seeks to improve upon their earlier separate proposals by building on comments received, including from an Expert Advisory Panel.
- **Addressing valuation uncertainty in fair value measurement guidance:** Further enhancements to IASB and FASB fair value measurement standards during the first half of 2011 will align requirements about how to measure fair value, including when markets become less active, and will address adjustments and enhanced disclosures for valuation uncertainty.
- **Offsetting/netting of financial instruments:** Differences between the current IASB and FASB approaches to the offsetting/netting of financial assets and liabilities can result in significant differences in the total assets of large financial institutions, according to the approach used. In response to stakeholders' concerns, including those of the FSB and BCBS, in January 2011 the Boards issued an exposure draft proposing changes to converge their standards on offsetting/netting of derivative contracts and other financial instruments.

VIII. Strengthening adherence to international supervisory and regulatory standards

The FSB in February 2011 published two country peer reviews, on Italy and Spain, and expects to publish two thematic peer reviews in March, on risk disclosures by market participants and mortgage underwriting and origination practices. Three new country peer reviews are scheduled for 2011, on Australia, Canada and Switzerland. Three thematic peer reviews will also be undertaken in 2011, on compensation practices (see below), deposit insurance systems and a topic still to be determined.

Reforming compensation practices to support financial stability

The G20 Leaders, at the Toronto Summit, encouraged all countries and financial institutions to fully implement the FSB Principles for Sound Compensation Practices and their Implementation Standards by end-2010 and called on the FSB to undertake ongoing monitoring in this area and to carry out another peer review assessment in 2011. As steps towards meeting this call, in September 2010, the FSB Secretariat requested that member national authorities share the results of any stocktaking exercises undertaken to gauge the progress of industry compliance with the Principles and Standards, along with information on the national regulatory framework in place concerning compensation structures and detail on the role of supervisors in examining compensation practices at financial institutions.

To support the 2011 peer review assessment, the FSB also established last year a working group to develop more detailed criteria to assess progress towards the implementation of the Principles and Standards. The criteria group is now concluding its work. The follow-up review will examine the implementation of the FSB Principles and Standards by significant financial institutions, focussing on the nature and extent of any weaknesses in the implementation, as well as on policy measures and actions taken by national authorities.

The Peer Review Team will be formed and begin its work in March in order to capture in this second thematic review the Spring 2011 bonus round. The thematic review report will be discussed by FSB Plenary in July and be published well ahead of the Cannes Summit.

Co-operation and information exchange initiative

The FSB in March 2010 launched an initiative to promote global adherence to cooperation and information exchange standards on financial regulation and supervision.[1] The initiative has met with considerable success so far; all but a few of the jurisdictions contacted by the FSB either already demonstrate sufficiently strong adherence to the relevant standards or are implementing reforms to strengthen their adherence.

At the November 2010 Seoul Summit the G20 Leaders called on the FSB "to determine by spring 2011 those jurisdictions that are not cooperating fully with the evaluation process or that show insufficient progress to address weak compliance with internationally agreed information exchange and cooperation standards, based on the recommended actions by the agreed timetable." The FSB will determine by April 2011 into which of several categories to place each jurisdiction under evaluation, including the identification of non-cooperative jurisdictions.

The FSB will publish in April 2011 a progress report, without the names of any jurisdictions, that summarises the status of the initiative and the next steps. The FSB will also consider the publication in late 2011, ahead of the November G20 Summit, of the names of all jurisdictions in the initial pool for further evaluation, including a list of non-cooperative jurisdictions.

XI. Other issues

Financial stability and regulatory issues in emerging and developing economies

A proposal has been prepared and discussed at the FSB Plenary for taking forward the work on identifying and examining financial stability issues that are of particular relevance for emerging market and developing economies. The end product will be a joint report by the

[1] See http://www.financialstabilityboard.org/publications/r_100310.pdf.

FSB, IMF and World Bank (WB) that will be sent to G20 Finance Ministers and Central Bank Governors in October. While the issues to be covered in the report will be identified jointly, the FSB, IMF and WB will divide amongst themselves primary responsibility in addressing individual issues according to their respective expertise and mandates, and will work together on cross-cutting issues. In order to avoid overlaps and the duplication of efforts, the report will focus on financial stability issues that are not being addressed adequately by existing international initiatives, while the recommendations will identify policy options to address those issues in a consistent manner across countries. The FSB's part of this work will involve a small working group that includes both FSB members and financial authorities that are not FSB members. A joint interim report will be discussed by the FSB Plenary in July, and it will then be presented for feedback to FSB regional consultative groups and other international fora before it is finalised.

Consumer Finance Protection

At the G20 Seoul Summit in November 2010, the Leaders asked the FSB "to work in collaboration with the OECD and other international organizations to explore, and report back by the next summit, on options to advance consumer finance protection through informed choice that includes disclosure, transparency and education; protection from fraud, abuse and errors; and recourse and advocacy." The FSB is establishing a consultative process to take forward this work, and a work plan will be finalised in late February 2011.

Reducing reliance on CRAs

The FSB's high-level principles to reduce reliance on CRA ratings, published in October 2010, aim to trigger a significant change in existing practices, setting out in broad terms the direction of change needed and asking standard-setters and regulators to follow up by defining the more specific actions that will be needed to implement the changes. The FSB will report to G20 Finance Ministers and Governors in April and October 2011 on progress in translating the principles into more specific policy actions and of the planned medium-term timetable and milestones, based on information collected from standard-setting bodies and national and regional regulators.

Addressing data gaps revealed by the financial crisis

In November 2009, the G20 Finance Ministers and Central Bank Governors endorsed 20 recommendations to address information gaps set out in the report "The Financial Crisis and Information Gaps" prepared by the FSB Secretariat and IMF staff. A follow-up report was prepared for the June 2010 meeting of Ministers and Governors in Busan. An updated progress report will be submitted to G20 Ministers and Governors in June 2011.

The FSB is leading work on recommendations 8 and 9 of the above report, aiming at improving collection and sharing of data on interlinkages between systemically important financial institutions and their exposures to countries, sectors and markets, through the development of a common draft data template. Work on those issues has been underway since March 2010 in a working group composed of national authorities and relevant international institutions, including the IMF, and the proposals for the draft template will be submitted to the FSB shortly. The work has also addressed data gaps in banks' funding structure and dependencies and has developed a draft set of recommendations on data sharing between authorities. Implementation of the new template will enable more informed microprudential and macroprudential assessments, support crisis management, and contribute to the data framework necessary for identifying and monitoring systemically important financial institutions.

Market integrity issues

At the Seoul Summit, IOSCO was asked to develop by June 2011 and report to the FSB recommendations to promote markets' integrity and efficiency to mitigate the risks posed to the financial system by the latest technological developments. IOSCO is working to report to the FSB on "dark pools" by June 2011, and to issue a consultation report on high-frequency and algorithmic trading by mid-2011, with a view to finalising policy recommendations in that area by October 2011. In addition, the FSB is monitoring key financial innovations, including in high-frequency trading and exchange traded funds, in order to identify potential emerging vulnerabilities at an early stage, with input from its members including the BIS Markets Committee and OECD.