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Statement by Mario Draghi
Governor
Financial Stability Board

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Chairman of the Financial Stability Board
to the International Monetary and Financial Committee

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The current strains in financial markets arising from sovereign debt concerns present urgent challenges for financial regulators and financial stability authorities. Sovereign and financial system risks are closely entwined. Relevant governments must play their part, by acting forcefully to strengthen fiscal positions and bolster competitiveness through structural reforms within concrete timetables. At the same time, the financial industry must continue to repair and strengthen balance sheets to rebuild resilience to shocks. The FSB is carefully monitoring market developments and actions to strengthen bank balance sheets, and its members are working together closely to support financial stability. The latest market events have underlined the need to press on and fully implement the global financial reform programme in order to establish more resilient financial institutions, markets and infrastructure.

The FSB continues to coordinate and drive forward international policy development in a range of financial reform areas. At the same time, the reform process is increasingly moving from the policy development phase to the period for national implementation of internationally agreed reforms. The FSB is intensifying its focus on detailed monitoring to ensure full and consistent implementation across its membership. This statement highlights some key priority areas for policy development and implementation.

Addressing systemically important financial institutions (SIFIs)

The FSB's initiative to address the systemic and moral hazard risks arising from SIFIs comprises action in five areas:

- First, improvements to resolution regimes so that any financial institution can be resolved without disruptions to the financial system and without taxpayer support;
- Second, a requirement that SIFIs and initially in particular global SIFIs (G-SIFIs) have additional loss absorption capacity beyond the Basel III standards to reflect the greater risks that these institutions pose to the global financial system;
- Third, more intensive supervisory oversight for financial institutions which may pose systemic risk;
- Fourth, stronger standards for the robustness of core financial market infrastructure to reduce contagion risks from the failure of individual institutions;
- Fifth, peer reviews by an FSB Peer Review Council of the effectiveness and consistency of national policy measures for G-SIFIs.

Following a public consultation exercise over the summer, the FSB is finalising policy recommendations in the first two of these areas, for delivery to the G20 Summit in November:

- The first paper will provide a comprehensive package of policy measures to improve the capacity of authorities to resolve failing SIFIs. It sets out proposed actions to improve national resolution regimes and tools, establish effective home/host co-operation arrangements and improve resolution planning by firms and authorities.
- The second paper will set out a methodology for assessing the global systemic importance of banks and the magnitude of additional loss absorbency that globally systemic banks will be required to have. It also describes the instruments that can be used to meet the loss absorbency requirements.

In addition, the FSB will publish a report in November on the progress being made to address the intensity and effectiveness of supervision, including the self-assessments that authorities have made of their mandates, resources and independence. Work is also underway to identify non-bank SIFIs and the appropriate policy measures that apply to them. The International Association of Insurance Supervisors is developing a methodology for identifying the systemic importance of insurers.

Shadow Banking

A key focus of the financial regulatory reform programme following the crisis has been to strengthen the regulation of the banking sector. However, stronger regulation of banks increases the incentives for regulatory arbitrage to conduct bank-like business outside the formal banking sector. Moreover, the crisis demonstrated that the shadow banking system can itself be a source of systemic risk, both directly and through its interconnectedness with the regular banking system, leading to a build-up of additional leverage and risks. Therefore enhancing supervision and regulation of the shadow banking system in areas where systemic risk and regulatory arbitrage concerns are inadequately addressed is important.

The FSB is developing recommendations for strengthening the oversight and regulation of shadow banking. An important element is to strengthen the monitoring of the sector. Initially, we are assessing the broad scale and trends of non-bank credit intermediation in the financial system, drawing on information sources such as flow of funds and sector balance sheet data, and complemented with other information such as supervisory data. The assessment focuses on four key risk factors: maturity transformation; liquidity transformation; imperfect credit risk transfer; and leverage. The work could lay the basis for data collection and assessment by the FSB of global trends and risks in shadow banking from 2012 onwards.

Work is underway, in collaboration with standard-setters, to gauge the case for further regulatory action in five areas:

- the regulation of banks' interactions with shadow banking entities (indirect regulation), in particular examining: consolidation rules for prudential purposes; limits on the size and nature of a bank's exposures to shadow banking entities; risk-based capital requirements for banks' exposures to shadow banking entities; and treatment of implicit support;
- the regulatory reform of money market funds;
- the regulation of other shadow banking entities;
- the regulation of securitisation, in particular with regard to retention requirements and transparency; and
- the regulation of activities related to securities lending/repos, including possible measures on margins and haircuts.

The FSB will publish a report on this subject in October.

Implementation monitoring

In the post-crisis period the FSB, in coordination with the relevant standard-setting bodies, has undertaken policy development work in a number of areas critical for strengthening global financial stability. Going forward, the success of these reforms depends on full, globally consistent implementation of the policies agreed. FSB member jurisdictions have made a commitment to lead by example. Therefore it is important to monitor, assess and report on the implementation of those commitments.

The FSB has already been reporting regularly since 2008 on progress in the development and implementation of reforms. We will intensify this through the establishment of a Coordination Framework for Implementation Monitoring, drawing on monitoring undertaken by individual standard setters as well as by the FSB. The framework will include particularly detailed monitoring in areas that are a priority for financial stability. One priority area will be the implementation of Basel III capital and liquidity standards, where the FSB will work closely with the Basel Committee on Banking Supervision to monitor full and consistent implementation by all member jurisdictions.

Another priority area is implementation of measures to reform the over-the-counter (OTC) derivatives market. This is a market whose global nature makes it particularly susceptible to regulatory arbitrage if reforms are not consistently implemented around the world. The complex, interlocking nature of the reforms that are needed makes cooperation across sectors and across jurisdictions particularly important. The FSB will publish in October its second six-monthly progress report on implementation of OTC derivatives market reforms, covering standardisation, central clearing, exchange or electronic platform trading, and reporting to trade repositories. This report, coming nearly two years after the G-20 commitments to reform this market and just over one year from the end-2012 deadline for full implementation, will deliver a more detailed assessment of progress toward meeting the commitments. In particular, it will follow up on the concern expressed in the first progress report in April 2011 that many jurisdictions may not meet the end-2012 deadline and that, in order for this target to be achieved, jurisdictions need to take substantial, concrete steps toward implementation immediately.

I have described here some of the key elements of the FSB's work programme. The FSB is also overseeing a variety of other important reforms. It is important that the international community sees through to the end their full implementation if we are to achieve a more resilient financial system.