FINANCIAL STABILITY BOARD

As prepared for delivery

22 July 2021

The lessons we are learning from the COVID-19 pandemic: an FSB perspective

The Asian Banker Finance China 2021 Conference: *New Era, new finance and new collaboration*

22 July 2021

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

Thank you for inviting me to Finance China 2021. I am sorry I am unable to attend in person, but I am optimistic that we will be able to travel more regularly and meet in person soon.

Vaccines are rolling out across the globe, even though at different pace across countries and regions. And while there are mounting signs of global recovery, some risks to financial stability still remain elevated. Economic uncertainty is still high and negative surprises could test the liquidity of financial markets. Moreover, while borrowing served as an important lifeline during the pandemic, in some jurisdictions solvency risk remains an issue amid higher corporate debt levels. And, collectively, we face the challenge of managing the potential spillover effects from an uneven pace of recovery across regions.

While remaining vigilant to emerging vulnerabilities, the FSB is beginning to draw lessons from the pandemic for financial stability. I would like to share a few preliminary reflections on those lessons with you today.

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The COVID-19 pandemic is the first major test of the global financial system since the G20 regulatory reforms were put in place following the financial crisis of 2008. The global financial system has weathered the shock so far, thanks to two factors: a determined and bold international policy response; and greater financial system resilience.

The policy response to the pandemic was unprecedented. Authorities acted swiftly to sustain the supply of credit to the real economy, support financial intermediation, and preserve global

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

financial stability, using fiscal, monetary, and prudential policy levers. These combined actions were effective in easing financial strains and in ensuring the continued supply of financing to the real economy.

Crucially, this policy response was supported by the stringent regulatory standards put in place by the G20 and coordinated through the FSB following the 2008 financial crisis. Because of these reforms, the financial system entered the pandemic in a more resilient state than during the 2008 financial crisis. Large banks hold more capital, have more liquidity and are less leveraged. This allowed them to cushion, rather than amplify, the macroeconomic shock. Financial market infrastructures, particularly central counterparties, functioned as intended.

Taken together, one overarching lesson from the pandemic concerns the crucial importance of a resilient global financial system. Let me elaborate on four areas of policy work that will be important to promote financial resilience going forward.

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First, it is important to complete the implementation of the remaining elements of the G20 reform agenda. Indeed, those parts of the global financial system where implementation of post-crisis reforms is most advanced displayed the greatest resilience. The financial stability benefits of the full, timely and consistent implementation of the reforms, including with respect to Basel III, over-the-counter derivatives or resolution frameworks, remain as relevant as when they were initially agreed.

At the same time, we need to ensure that the reforms are working as intended. The evidence we have gathered thus far already suggests some specific elements of the regulatory framework that warrant further examination. These include the role and usability of capital and liquidity buffers; the performance of countercyclical elements in prudential regulation; and potential remaining sources of excessive procyclicality, whose impact may have been dampened or delayed as a result of the official sector support.

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Second, there is a need to strengthen resilience in the non-bank financial intermediation (NBFI) sector. In March 2020, key funding markets experienced acute stress. This highlighted vulnerabilities in particular activities and mechanisms in the sector stemming from liquidity mismatches, leverage and interconnectedness, which may have caused liquidity imbalances and propagated stress. In response, the FSB has developed a comprehensive work programme to enhance the resilience of the NBFI sector while preserving its benefits.

As a first deliverable under the NBFI work programme, we have developed policy proposals to enhance the resilience of money market funds. These proposals are currently out for public consultation. We will use this feedback to develop our final proposals, which will be delivered to the G20 for approval in October. We also have work underway on open-end funds, margining, bond market structure and liquidity, and cross-border dollar funding. Once we have completed this work on individual risk drivers, we will focus on the issue of system-wide risks in NBFI and ways to address them.

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Third, the pandemic experience has also reinforced the need to promote resilience amidst rapid technological change in the economy and the global financial system. Financial institutions and FMIs moved to a remote working environment without major reported incidents. No major cyber incidents have been reported in the financial system but the number of cyber attacks has increased. More generally, working from home arrangements propelled the adoption of new technologies and accelerated digitalisation in financial services.

While outsourcing to third-party providers, such as cloud services, seems to have enhanced operational resilience at financial institutions, increased reliance on such services may give rise to new challenges and vulnerabilities[2]. Effective management of such risks across the supply chain is essential to mitigating operational and cyber risk. This is an important part of the broader FSB agenda to address financial stability risks from digital innovation while harnessing its benefits, including work on crypto assets and new entrants into the provision of financial services.

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Last but certainly not least, we need to address the financial risks of climate change. Work in this area has gained considerable momentum in multiple forums, and – given the global and cross-sectoral nature of climate change – the FSB has a natural role to play in helping to coordinate, shape, and seek agreement on a path forward in this space. To this end, the FSB has developed a roadmap for addressing climate-related financial risks. The roadmap, which we published at the start of the month, identifies where climate-related work on financial risk is underway, and what work is needed, in four closely related areas: (i) firm level disclosures; (ii) data needs for the assessment of climate-related financial risks; (iii) the assessment of financial vulnerabilities from climate change; and (iv) the development and application of regulatory and supervisory tools.

The FSB's focus is on addressing financial risks related to climate change, rather than promoting green – or 'sustainable' – finance. But the two are complementary. Financial resilience, is a precondition for the stable provision of sustainable finance. By the same token, sustainable finance based on sound risk management contributes to financial resilience.

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Let me conclude. The FSB's work since the beginning of the pandemic demonstrates the continued commitment of the international community to take the necessary steps to ensure the resilience of the financial system and support continued financing of the real economy under extraordinary circumstances. This international cooperation will be critical as we navigate our way out of the COVID pandemic, supporting a resilient financial system and ensuring a strong, sustainable global recovery.

Thank you very much. I wish you a productive meeting.

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[2] See Regulatory and Supervisory Issues Relating to Outsourcing and Third-Party Relationships: Discussion paper