B20 AUSTRALIA 2014

B20 FINANCING GROWTH TASKFORCE POLICY SUMMARY

JULY 2014

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Taskforce constitution and process

The Australian Prime Minister appointed more than thirty Australian CEOs to guide the work of the B20 Australia in 2014 under the leadership of Richard Goyder AO, CEO of Wesfarmers, and B20 Sherpa Robert Milliner. B20 Australia continued four of the seven priority areas pursued under the Russian presidency of 2013 to reflect the Australian G20 presidency's focus on boosting economic growth and creating jobs. Financing Growth is one of those priority areas. The others are Trade, Infrastructure & Investment and Human Capital. An Anti-Corruption Working Group has also been established to focus on corruption issues across the four taskforces.

Leadership

The Financing Growth Taskforce was established under the leadership of coordinating chair Michael Smith OBE, CEO of Australia and New Zealand Banking Group, and co-chairs Peter Sands, CEO of Standard Chartered plc and Andrey Kostin, CEO and Chairman of VTB Bank.

Membership

Financing Growth Taskforce Members are mostly senior executives from business, business associations and professional services firms. The taskforce is also ably assisted by Supporters from those organisations and with in-depth project support from McKinsey and Company. Members and Supporters either continued as members of the preceding taskforce under the Russian B20 presidency, or were invited to join in 2014 by the coordinating chair. The membership is broadly representative of the G20 countries, and there is strong representation from emerging market economies and the non-financial sector.

Policy development

The policy development process began with a scoping exercise to develop themes for investigation. Each theme was then deeply researched and debated within the taskforce to generate draft recommendations. The draft recommendations were then refined in an iterative process and a series of actions developed to test the practicality of each recommendation. The Taskforce met four times before the B20 Summit and exchanged ideas and material between meetings. See page 25 for details.

In the development of the analysis and recommendations, various reports published by global standard setters on the development and operation of global rules were reviewed. This was supplemented by a survey undertaken to elicit feedback from firms in terms of the impact of regulation on day-to-day business transactions. Given the staggered implementation of the global rules, some of the concerns expressed relate to potential or possible impacts from the rules once they are fully operational. The B20 Financing Growth Taskforce has also undertaken a 'Voice of the Customer' survey to collect real economy examples of the impacts of regulation on financial and non-financial sector companies. This is available at www.b20australia.info/Pages/FinancingGrowth.aspx

Summary of recommendations

Context

G20 mandate to lift global growth

The G20 Finance Ministers and Central Bank Governors have recognised that the global economy remains far from achieving strong, sustainable and balanced growth, despite recent signs of improvement. Following their meeting in February 2014, they committed to developing new measures to significantly raise global growth.[1]

The G20's aim is to develop policies that lift collective GDP by more than 2 per cent above the trajectory implied by current policies over the coming five years. Emerging markets and developed markets alike will face significant adjustment pressures over the coming decades. Governments in both advanced and emerging economies will need to meet the growing challenge of infrastructure investment,[2] ageing populations, economic growth and job creation.

To achieve the necessary change, the G20 Ministers stated that they are committed to taking concrete actions to increase investment, lift employment and participation, enhance trade and promote competition, in addition to macroeconomic policies. These actions are to form part of each country's growth strategy.

In particular, Ministers committed to:

- Focusing efforts on substantially completing, by the Brisbane Summit, key aspects of the core regulatory reforms in response to the global financial crisis
- Creating a climate that facilitates higher investment in infrastructure and small and medium enterprises (SMEs)
- Undertaking reforms to remove constraints on private investment by establishing sound and predictable policy and regulatory frameworks, and emphasising the role of market incentives and disciplines.

B20 Financing Growth Taskforce Action Plan

To support Ministers in achieving their objectives, the B20 Financing Growth Taskforce proposes a range of targeted actions intended to support the global growth strategy. This Action Plan takes account of the work in the complementary B20 Taskforces on Trade, Infrastructure & Investment and Human Capital. Access to finance plays a major role in ensuring the success of policies in these key areas of growth.

Overall, the ongoing challenge of stimulating growth will be facilitated by finalising the four core reforms to the financial system by the Brisbane Leaders Summit (building resilient financial institutions; ending too-big-to-fail; addressing shadow banking risks; and making derivative markets safer) and implementing them according to agreed timelines. This would address the uncertainty that may have constrained the provision of credit in some markets. This would also enable the financial regulatory agenda to transition from the crisis response phase.

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1 Communiqué, Meeting of G20 Finance Ministers and Central Bank Governors, February 2014 (https://www.g20.org/sites/default/files/g20_resources/library/Communique%20Meeting%20of%20G20%20Finance%20Ministers%20and%20Central%20Bank%20Governors%20Sydney%2022-23%20February%202014_0.pdf).

2 Swiss Re and the Institute of International Finance estimate that current annual levels of infrastructure spending of USD2.6 trillion are expected to grow to USD4 trillion annually by 2030; diversification of long-term investment funding sources is essential to meet these financing needs (http://www.swissre.com/rethinking/financial_stability/infrastructure_investing_it_matters.html).

As part of this transition, it will also be timely to review financial regulatory processes at the Financial Stability Board (FSB) and the other standard setting bodies. At the same time we support complementing the financial regulation agenda with much-needed reforms that deepen the range of sources of financing for investment in order to strengthen sustainable medium-term growth.[3]

Our real economy case studies (available at www.b20australia.info/Pages/FinancingGrowth.aspx) provide a direction where further work could be undertaken to gauge the impact of the regulatory changes. The case studies reinforce the B20's call for finalising the core reforms and taking stock before any further significant regulatory change is considered.

This Report is in two parts. **Part A** deals with structural reform to the global regulatory framework. **Part B** proposes refinements to the impact of global rules on financial inclusion, infrastructure financing and trade finance.

The B20 recommends:

Part A

1. *Effective Regulation* – the core reform program to be completed, the fragmented and incomplete implementation of existing reforms to be examined and new processes designed for developing future international regulation established.
2. *Emerging Market Economies (EMEs)* – international standard setters should ensure they take greater account of the economic and development environment in EMEs when developing global rules. More effective representation of EMEs on global rule makers is needed to ensure this.

Part B

3. *Financial Inclusion* – G20 Finance Ministers should review existing regulation to determine whether the combination of new prudential and conduct regulatory standards inadvertently results in a restriction of access to finance, particularly for EMEs and for small and medium enterprises (SMEs). Ministers could consider whether there are ways in which the regulatory objectives can be achieved while mitigating these unintended consequences.
4. *Infrastructure Financing* – international standard setters and governments should seek to remove disincentives for the development of investment in long-term infrastructure projects.
5. *Trade Finance* – international standard setters should ensure that new and existing standards, developed to provide stability and to protect the system from money laundering and corruption, do not unnecessarily impede the availability of trade finance. Initiatives, such as a framework for mutual recognition for due diligence requirements, could ameliorate this impact.

3 International Monetary Fund, 2014, Global Prospects and Policy Challenges, (http://www.imf.org/external/np/g20/pdf/2014/021914.pdf).

Part A - Structural reforms to improve market resilience and establish new rule making processes

Improving global regulation of markets

Summary

Recommendation	Effective global regulation of markets
Reference	FG1
Owner	FSB, Finance Ministers, Basel Committee on Banking Supervision
Timing	Stage One: 2014/15; Stage Two: 2015
Value	US$19 trillion
KPI	Global lending volumes
Current (Target)	US$81 Trillion in 2012 (US$100 Trillion in 2017)

Context

As part of the transition from the crisis response phase, the B20 encourages international regulators to both push to substantially complete the core agenda in 2014 and to pause, take stock and align the regulatory agenda in 2015 to ensure that it is coherent, consistent and working as intended.

The B20 approach to regulatory reform involves two stages: finalisation of the existing agenda of core reforms in 2014 and an enhanced approach to regulatory policy development commencing in 2015.

The B20 has supported the extensive efforts of the G20 to increase the resilience of the global banking system and the broader financial sector following the Global Financial Crisis. The banking system is more strongly capitalised (with higher levels of and better quality capital), less leveraged and more liquid than pre-crisis.[4]

Sound regulation of the financial system is critical for the proper functioning of markets and the global economy, and is an important enabler for sustainable and long-term economic growth. However, it is important that we do not build a regulatory system that unduly hampers intermediation and the supply of new credit as this would lead unnecessarily to reductions in the provision of credit.

It is critical that as the regulatory agenda transitions from the crisis-response phase, regulatory processes at the FSB and standard-setting bodies are reviewed, tested and adapted where necessary. Strong processes are critical in ensuring the financial regulatory agenda carefully balances the need for financial stability with the leverage necessary to enable the flow of credit in the economy. Inclusive, deliberative, and carefully evaluated policy development is required to achieve this.

Value

Improved coordination and the reduction in distortions in the global financial system is estimated to increase global lending volumes by 5 per cent per annum or a total of US$19 trillion by 2017.

4 See results of the Basel III monitoring exercise as at 30 June 2013 published on 6 March 2014.

Actions

Stage one regulatory reform agenda: complete major reforms in 2014 to promote stability

Market participants are concerned about the uncertainties that remain in the regulatory environment whilst the key reforms are being finalised and implemented, and the divergent treatment of some new rules across jurisdictions.[5]

As a first step towards finalising effective global regulation, the B20 agrees with the G20 that the key reforms that should be finalised as soon as possible are: capital and liquidity requirements under Basel III; enhanced regulation of global systemically important financial institutions (G-SIFIs); over-the–counter (OTC) derivatives markets and market-based finance (shadow banking).

The FSB is currently working to strengthen cross-border cooperation and information sharing and to promote regulatory coherence, thus avoiding fragmentary domestic measures.[6] The B20 strongly supports these efforts.

The B20 supports the Basel Committee on Banking Supervision (BCBS) and FSB's commitment to finalising a difficult and complex regulatory agenda this year to improve the stability of financial markets. In completing this program, it is important that an appropriate balance is reached in the design of the measures between contributing to stability and not unnecessarily inhibiting credit creation. The B20 acknowledges the consultation processes which are being undertaken in the development of these proposals and will seek to assist in their implementation.

Specific issues that are intended to be completed by the Brisbane Leaders' Summit and which need to be resolved during this program are:

- The primary measure of capital solvency should be the **ratio of capital to risk-weighted assets**. Regulators and banks should work together to improve risk weighting methodologies to remove unmerited differences and discrepancies and to enhance alignment to underlying risk characteristics. A risk-based measure of capital adequacy is a foundation stone of the Basel III framework and also promotes good risk management in banks. This approach is supplemented by stress tests and the leverage ratio as backstops to the risk based ratio, which should remain the primary measure of capital adequacy.

- The **leverage ratio** (recognising that leverage is a required function of a financial system) and the **net stable funding ratio** will require careful impact analysis and calibration before the rules are finalised.

- In addressing the **regulation of G-SIFIs** and ensuring globally consistent resolution regimes, the development of gone-concern loss absorbing capacity (GLAC) for G-SIFIs should give clear guidance on what should be eligible liabilities, the amount of GLAC that should be held and where that capacity should be located in a banking group. The international framework being developed should place reliance for the determination of the amount and location of GLAC on lead regulators and crisis management groups as part of the resolution planning process.

- The cross-border recognition of national regulators' **resolution actions** needs to be encouraged to avoid fragmentation in global regulation and to secure greater crisis management coordination.

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5 For example, the corporate carve-out for the Basel III Credit Valuation Adjustment, which has been implemented across the European Union but not elsewhere, leading to non-uniform practices and increased costs for corporates seeking to mitigate their risk exposures.

6 The FSB also plans to propose a framework to share information on shadow banking entities and associated policy tools, as well as developing a global standard for gone-concern loss-absorbing capacity (GLAC) to be held by global systemically important banks.

- In addressing **market-based financing (shadow banking)** risks, a balance needs to be maintained that recognises the legitimate role of these activities in the capital market while mitigating potential spill-over effects on the financial system.

The regulations for making **derivatives markets** safer should address the overlapping and sometimes conflicting nature of national regimes, for example in central clearing and margin setting. These regulations need to take account of the important role that derivatives play in terms of facilitating underlying financial activity with particular regard to infrastructure and trade finance.

Stage two regulatory reform agenda: monitor progress and establish processes in 2015

Establish new rule-making processes

The B20 proposes that there be improved processes for the development of global rules. These could include the adoption of high-level principles for regulation; process reviews to ensure they are 'fit for purpose', enhanced consultation with business communities and a better understanding of the impact of regulation on the real economy.

The regulatory reform agenda initiated by the G20 is unprecedented in scale and scope, and the resulting improvement in global financial stability is far-reaching. After the completion of implementation of current reforms, the B20 believes that the FSB, and standard setting bodies such as the BCBS, the International Association of Insurance Supervisors and the International Organisation of Securities Commissions (IOSCO), should ensure that they have established mechanisms to assess the impact of proposed new reforms, their complementarity (or otherwise) with existing regulations and potential spill-over effects.

As the FSB transitions from the crisis response phase, it should consider reforms to its processes, such as subjecting new policy proposals to a more effective pre-assessment of their potential impacts, their relative priority in the FSB agenda, and their relevance to emerging and advanced economies, prior to being added as agenda items. In addition, global standard setters should also undertake post-implementation reviews to understand whether the economic impact of reforms has been in line with the projections of the pre-assessments.

This process could contribute to better dialogues between policymakers and regulators at the initiation of policy making, reasonable rulemaking timelines coordinated across jurisdictions and a process for identifying and bringing together regulators when differences emerge. We welcome efforts by global standard setters such as IOSCO to address contradictory legislation which could have the impact of fragmenting markets.

To reduce divergence and increase mutual recognition, these processes should deal with rule making, including cost/benefit analysis, consultation mechanisms, implementation policies and post-implementation reviews of the impact of the regulation.

The B20 would like to collaborate with the global standard setters to address the immediate issues[7] and also set out a longer-term framework for ensuring more co-ordinated implementation of current and future globally-agreed standards.

For example, it is important to address greater consistency and comparability of risk weighting of bank assets. Banks are committed to improving the risk weighting of assets. Banks will continue to place emphasis on their internal risk management focus as well as supporting reforms to revised methodologies. This should retain the incentives to appropriately price economic risk, rely on the ability of banks to apply long-standing expertise to credit decisions and provide an incentive to investment in risk management.

7 The leverage ratio, the net stable funding ratio, risk-weighted assets and GLAC will need careful examination before the rules are finalised.

Annual reports by BCBS and FSB to Ministers

Importantly, to ensure that the new rules are working effectively to improve stability of the global financial system, the FSB and BCBS's annual report to G20 Leaders on the implementation and impact of the new rules needs to deal with the real economy effects of the enhanced regulation. An holistic approach is required which reports on the improvements in stability for the financial system as well as how markets have adapted to the enhanced regulation.

An agenda which could be adopted for annual reviews could include various matters that are discussed in this report: issues relating to financial inclusion, difficulties of SMEs raising finance, infrastructure financing through capital markets and the impact of anti-money laundering regulation on trade finance.

Ref	Action
FG1A	*Stage One – 2014:* The B20 strongly supports the BCBS and the FSB's commitment to finalising a difficult and complex regulatory agenda this year to improve stability of financial markets. The core reforms to the financial system identified by Ministers for completion in 2014 need to be implemented in a way that promotes an integrated global financial system, addresses harmful fragmentation, and avoids unintended costs for business and the real economy.
FG1B	*Stage Two – 2015:* Finance Ministers should adopt a protocol for international standard setting bodies for a more comprehensive approach to the development, implementation and impact assessment of the agreed regulatory agenda. To reduce divergence and increase mutual recognition, this protocol should deal with rule making including cost/benefit analysis, consultation mechanisms, implementation policies, and post implementation reviews of the impact of the regulation.
FG1C	*Stage Two – 2015:* The annual report of the BCBS and the FSB to G20 Leaders on the implementation of the global rules should note the impact on stability and economic growth, including any unintended effects of the new rules, especially on access to finance for SMEs and issues of financial inclusion.

Greater recognition of emerging market economies

Summary

Recommendation	Greater recognition of emerging market economies
Reference	FG2
Owner	FSB, Finance Ministers, BCBS
Timing	December 2015
Value	US$15 trillion
KPI	GDP contribution of emerging markets, %
Current (Target)	40% in 2013 (48% in 2017)

Context

The B20 notes that the FSB is currently reviewing the structure of its representation. The B20 considers this is a timely opportunity for the global regulatory bodies to acknowledge the role of emerging market economies and provide them with more effective representation and greater participation.

While EMEs are currently consulted and are represented on some committees, the FSB should seek to ensure emerging markets perspectives are actively incorporated in decision-making processes. This will ensure appropriate weight is given to the social, economic and financial challenges faced by emerging markets.

Many emerging markets are dealing with multiple macro-economic challenges. Three in particular deserve mention. First, emerging markets' central banks have to deal with the after effects of the withdrawal of extraordinary monetary stimulus by advanced economies. Second, emerging market economies are dealing with lower growth prospects. Third, banks and financial services companies in emerging market economies have to implement the global financial regulatory agenda at an uncertain time.

In effect, many emerging markets are coping with the prospect of both seeking to develop their markets whilst at the same time changing some of the fundamentals to accommodate global regulatory changes.

The B20 believes that the G20 needs to understand these pressures, better reflect the views of emerging markets in policy development, and support those countries in their efforts to develop deeper financial markets.

Value

Improving the role of emerging market economies in the development of international regulation has the potential to improve the global contribution of emerging markets to gross domestic product by 11 per cent per annum, or $US15 trillion, by 2017.

Actions

Rule-making processes to take greater account of emerging markets

The development of liquid financial markets in EMEs would enable governments to address many of the current social and economic challenges, however this can only be achieved within a legislative and regulatory framework which will facilitate this. At a macro-level, financial markets can help to provide funding solutions for large infrastructure projects.

Care should be taken by global rule setters not to unnecessarily hinder these markets' development by imposing rules suited to advanced economies, such as global "bail-in" standards in markets where banks are predominately deposit-funded and debt capital markets are being developed. There are also difficulties for emerging markets in meeting OTC markets regulation, due to the lack of central counterparty clearers and the operation of anti-money laundering rules.

It has been suggested that if global rule setters were to give greater consideration to the suitability and impact of new regulatory requirements on emerging economies, then these issues would be addressed.

As well, B20 members consider that there would be greater global acceptance of the merits of the reforms endorsed by the G20 for financial systems if they were seen to more appropriately take account of financial systems developing in emerging economies.

At present, the reform measures largely address problems that arose in Europe and the US. As the financial regulation agenda transitions from the crisis response phase, it would seem timely for the G20 to give more consideration to how financial systems can assist growth in emerging market economies, and better manage risks in these markets. This implies a need to bring EME policymakers into policy dialogues more fully and also assess the social, economic and financial challenges that these countries will face over the coming decades. For example, the Asian financial sector now represents 37 per cent of total world banking and insurance market capitalisation, up from 16 per cent in 2003.

It is important for standard setters to fully appreciate that outside the deep financial markets in the US and EU, many other economies face issues such as dependence on cross-border funding, inadequate financial market infrastructure and a limited availability of hedging products.[8] Understanding these fairly significant differences between financial markets is essential if policy is not to inhibit growth.

Improved representation of emerging market economies on global standard setters

Greater participation and engagement by emerging markets in setting global standards will be essential in ensuring that the global financial system is regulated in a way that recognises different stages of development, and the different risks faced by emerging market financial systems that can flow back to advanced economies.

The objective should be for emerging markets to have deeper and more liquid financial markets, but while this transition is happening, it will be important to ensure global reforms do not have an unnecessarily inhibiting impact on these developments.[9] To address social and economic challenges, the G20 and international standard setters must engage emerging markets as they seek to develop their capital markets. Recognition should be given to the importance of trade finance to high-growth markets, the lack of central counterparty clearers, the difficulties of contract enforceability, and netting and set–off in some markets.

8 For instance, at USD42.6 trillion the total notional amount of outstanding derivative contracts in Asia is ~6% of the total global notional of around USD700 trillion.
9 For example, ISDA has noted the risk of increased fragmentation in global derivative liquidity as the US implements its Swap Execution Facility ("SEFs") rules (http://www2.isda.org/attachment/NjlzNw==/Cross%20Border%20Fragmentation%20-%20An%20Empirical%20Analysis.pdf).

Only through emerging markets having more active participation at the FSB, and other standard-setting bodies, will the global rules be better refined to achieve their objectives in the least disruptive way for these economies.

Giving a greater voice to emerging markets and ensuring their effective representation on global standard setting bodies will ensure that issues that have arisen concerning the impact of global rules in restricting financial inclusion can be properly taken account of at the rule development stage.

Ref	Action
FG2A	The FSB's current review of its structure must ensure that EMEs are effectively represented so that their perspectives can be actively incorporated in decision-making processes. Appropriate weight needs to be given in global regulatory bodies to the social, economic and financial challenges faced by EMEs.
FG2B	The BCBS, FSB, IOSCO and the Financial Action Task Force (FATF) need to ensure regulations being developed take account of the differing market conditions in emerging markets and where appropriate, be fine-tuned or recalibrated for application in these markets.

Part B - Refinements to global rules to improve financial inclusion, infrastructure financing and trade finance

Facilitating financial inclusion

Summary

Recommendation	Facilitating financial inclusion
Reference	FG3
Owner	FATF
Timing	December 2015
Value	US$16 trillion
KPI	Growth in cross-border trade flows
Current (Target)	US$43 trillion in 2012 (US$59 trillion in 2017)

Context

The provision of finance plays a central role, ensuring that all members of the community are economically and financially included. However, there are areas where, in advanced and emerging markets, financial reforms can unintentionally restrict financial inclusion. This has the potential to become a major unintended effect of increased supervisory and enforcement activity by regulators, manifesting in problems for banks in day-to-day operations with customers and restrictions on lending to businesses. As noted, the lack of representation from EMEs on global standard setters may have contributed to restrictions on financial inclusion in some market segments.

Review impact of global rules on financial inclusion

Financial institutions recognise the vital role they play in ensuring integrity of financial markets through implementing anti-money laundering and counter terrorism financing laws. The B20 fully supports the prudential, conduct of business and anti-money laundering/counter-terrorism financing (AML/CTF) regulatory agendas, which are critical building blocks for a secure and stable financial system. However, as part of broader processes to review the impact of reforms, consideration should be given to adjusting these measures to improve their overall application.

The combination of Basel III prudential rules, in relation to SME lending, and the manner in which the array of conduct of business regulations are enforced, including AML/CTF, selling standards, and bribery and corruption, are, in some instances, restricting the provision of finance to certain client segments, which are increasingly difficult to service cost-effectively. A small cross-border SME will get pushed into accessing finance from the informal sector. Our concern is that this issue is impacting a variety of marginal and underrepresented sectors of society, most commonly higher risk segments in higher risk jurisdictions.

The costs imposed by these regulations may risk being disproportionate in some sectors in terms of improving conduct standards and addressing corruption. In effect, customers are inadvertently excluded and need to use alternative informal financing modes, which are both more expensive and outside regulatory scrutiny, thus undermining the objective of the regulations.

Well-intentioned rules, designed for sophisticated markets, can have powerful unintended effects, particularly when combined with other rigorous standards around new capital and liquidity rules.

The three key examples of this impact are SME financing, correspondent banking and remittances, described further below.

Harmonisation of regulations such as those under development, dealing with beneficial ownership transparency and a consistent approach to enforcement and sanctions, would mitigate the cost and associated unintended consequences. This would incentivise financial service providers to embed the right behaviours which would promote financial inclusion.

Monitoring of SME financing

SME lending is a particular concern for market participants globally. SMEs, which typically account for 80 per cent to 90 per cent of job creation in an economy, are especially reliant upon bank financing as they have very limited access to capital markets debt financing. Any reduction in the supply of credit through an unnecessary limitation of banks' capacity to lend will impact on SME financing and hence economic growth.

There is concern in some advanced and emerging markets that as the new capital regulations are implemented, and with continued difficult credit conditions, banks may not be able to satisfy all of the funding requirements of SMEs.

To address these concerns, a holistic review, from the point of view of the entity seeking finance, needs to be conducted of the impact of the new prudential rules and the ongoing impact of the conduct of business and customer due diligence requirements.

In addition, greater consideration could be given to alternative arrangements for the provision of finance to SMEs. For instance, the EU has introduced a reduction in the capital requirements for banks' exposures to SMEs. This could be considered by other countries.

Impact on correspondent banking

In terms of correspondent banking for cross-border payments, the B20 found that there was some evidence of financial exclusion. A recent survey found that correspondent banking services have been reduced or modified in some emerging market regions.[10] Banks are increasing their level of scrutiny through rigorous due diligence processes for new and existing correspondent banking relationships following the introduction of anti-money laundering/customer due diligence regulations.

Costs of complying with new rules, institutional reputation and punitive fines for breaches has had the effect of global banks shrinking their services to emerging market banks in some markets. This can have a more marked impact on emerging markets as corporates in the region tend to rely much more on global bank lending.[11]

Restrictions on remittances

In terms of remittances to developing countries, there is evidence of banks pulling back from remittances business to avoid having to deal with non–regulated organisations which are not subject to anti-money laundering rules.

A recent report by the World Bank noted that remittances remained a key source of external resource flows for developing countries, far exceeding official development assistance and more stable than private debt and portfolio equity flows.[12] For many developing countries remittances

10 B20, *Voice of the Customer*, research for the B20, 2014.
Available at http://www.b20australia.info/Pages/FinancingGrowth.aspx
11 The most obvious example is in the area of anti-money laundering regulation, which fails to reflect the difficulties of identifying customers in emerging markets, the marginal costs and the disparity between the domestic and global standards.
12 World Bank, *Migration and Development Brief*, April 2014.

are an important source of foreign exchange, surpassing earnings from major exports and covering a major portion of imports.

The report noted that continued efforts are required to lower the cost of sending money through official channels, although inroads are being made. The World Bank report commented that more needs to be done to ensure that AML/CTF regulations do not unduly undermine the development objectives and harm the poor.

There is a particular set of issues relating to banks and Money Transfer Operators (MTOs), small-scale remittance facilitators, and their inability to comply with AML/CTF regulations. In order to offer formal financial services a bank must first "know your customer". It is often difficult to really "know" customers in emerging markets because they do not commonly have identification.

Role of institutions and market supervisors in assisting financial inclusion

Financial institutions are the front-line implementers of business rules, especially those involving market conduct. Such bodies understand the importance of having market integrity. Supervisors can play their role by working with institutions on the implementation of the conduct rules and ensuring, especially where there are cross-border transactions, that there is compatibility in the way the rules are interpreted and enforced by the relevant supervisors. The B20 considers that emerging markets are seeking to improve their corporate governance standards over time, and that this should be taken into account by global rule setters and regulators.

As part of broader processes to review the impact of reforms, global standard setters need to work with regulators to understand how their standards impact on the provision of financial services and give consideration to adjusting these requirements to improve their application and avoid unintentionally excluding certain customer segments.

In summary, the G20 should instruct the BCBS and the FSB, in consultation with IOSCO, to consult and report back on any restrictions on the level of financial inclusion due to the unintended consequences of the regulations on the conduct of business and how the regulations could be modified to reduce those impacts.

Case Study: Large Asian universal bank

"Regulation is not onerous… but implementation is creating uncertainty, meaning we are overly cautious during operations. In addition, as part of a rigorous screening process we have exited numerous financial partnerships. We will continue to do so, even if it means exiting countries."

- Uncertainty in implementation has led to BankCo being overly cautious during operations e.g., KYC regulation requires due diligence during customer on-boarding to go for 2 days, however BankCo has put in place a 3 day due diligence policy
- BankCo has taken a systematic review of countries and financial services providers to 'screen' partners—resulting in strategic exits from numerous partnerships. However, no country has been left without a correspondent bank
- Competitors are also exiting from markets. BankCo faces concentration a risk where competitors have exited.

Value

Improving financial inclusion through refinements to existing rules has the potential to increase growth in cross-border trade flows by 7 per cent per annum or $US16 trillion by 2017.

Actions

Ref	Action
FG3A	The G20 and standard-setting bodies should give greater consideration to the impact of the financial regulation reforms on facilitating financial inclusion.
FG3B	The FATF should work with the World Bank and other relevant organisations including international banks and the Global Partnership for Financial Inclusion to better understand the effect of global anti-money laundering rules on access to finance and the changes that need to be made to address restrictions on access whilst also tackling financial crime. The B20 recommends AML/CTF regulation be reviewed to see whether it can better accommodate the difficulties of identifying customers in emerging markets, taking into account the marginal costs in maintaining AML regimes and the disparity between the standards under which global and local banks have to operate.
FG3C	Ministers should direct the BCBS and the FSB to work with the relevant organisations to holistically review whether existing prudential and conduct rules are restricting financial inclusion amongst SMEs and underrepresented sectors of society, particularly in higher risk segments and jurisdictions.

Facilitating greater infrastructure financing

Summary

Recommendation	Facilitating greater infrastructure financing
Reference	FG4
Owner	BCBS, FSB, World Bank, OECD
Timing	December 2015
Value	US$57 trillion (to 2030)
KPI	Global wholesale revenue growth
Current (Target)	US$2.7 trillion per annum (US$3.7 trillion per annum)

Context

The B20 recognises there is a clear way to assist Ministers in reaching their global growth target through increased infrastructure investment by the private sector. Ministers stated that they were committed to creating a climate that facilitates higher investment in infrastructure.

It is likely that the tightening of prudential regulatory requirements for banks will mean there is an increasing role for capital markets and institutional investors to play in infrastructure financing. Large pools of long-term funds, such as pension funds and insurance companies, would be available for such investments if the right policy settings could be established in terms of capital requirements.

Development of new financial instruments to facilitate market development

There is a need for infrastructure markets to be developed, domestically and internationally, supported by specially developed capital instruments. This would entail the development of instruments offering different risk-return characteristics suitable to a wider range of institutional investors. More marketable instruments would increase the pool of investable and attractive long-term assets and the supply of private financing from long-term investors. The development of deep, liquid capital markets will help to reduce the costs of funding for business and will ultimately mean that markets are less volatile.

Governments could consider the steps they will take to meet increased funding needs. Such strategies could include the sale of existing assets to the private sector to fund new projects, government co-funding of availability payments, capturing more value from land developments associated with infrastructure projects, government guarantees (e.g. guaranteed rates of return on investment for an initial period), and the introduction of community charges for use of the asset.

Measures to facilitate private sector infrastructure investment

Countries will use a variety of methods to finance their infrastructure needs, which reflect their specific circumstances. The public sector plays a significant role in funding public infrastructure projects through its budget, borrowings or government trading entities. However, valuable infrastructure still needs to be provided by private funding.

The risk-return profile of an infrastructure project will determine the extent of private sector involvement. There is no shortage of private sector capital that could be potentially deployed to finance global public infrastructure. However, the right policy settings must be in place to access the full potential of this pool of capital.

Governments need to determine how much risk relating to an investment they are willing to bear taking account of the risk management framework for the project, transaction costs and the exposure of the project to market disciplines. Strategies can be adopted to mitigate project completion risk and the operational risks of infrastructure through insurance and reinsurance arrangements.

Higher levels of private investment in infrastructure will come from:

- Development of infrastructure plans by governments of future needs including a pipeline of projects
- Governments addressing political and regulatory risks
- Development of investor value propositions for individual projects with appropriate risk-return trade-offs.

An attractive environment for investment requires certainty and measures to address political risk, including renegotiation risk. Risk sharing between the government and the private sector should be seen in the context of cost-benefit and value for money.

Measures that could be adopted to develop a market for infrastructure investments range from co-sponsorship with the private sector through use of public/private partnerships through to specific limited actions to mitigate the risks involved in some part of a project.

Financing risk-sharing mechanisms that can be used to attract private sector investment are:

- The establishment of a public/private partnership to raise finance for a project
- The issuance of infrastructure bonds by the public and private sector
- The use of government credit guarantees for borrowings and concessional loans
- Demand risk insurance
- Use of availability payments
- Financing from brownfield infrastructure sale proceeds (recycling).

Government trading entities, public/private partnerships or contractual arrangements could be established to manage these mechanisms and to protect taxpayers' funds.

International Financial Institutions and Multilateral Development Banks should assist in developing a more conducive environment for long-term investors by developing best practice bond documentation and due diligence processes and encouraging best practice procurement behaviours.

Given the global nature of longer-term investors, the private sector should work with the public sector to develop infrastructure as a separate asset class through more attractive risk/return characteristics and standardisation of the various elements of an infrastructure investment. Further discussion on the investment instruments is included at www.b20australia.info/Pages/FinancingGrowth.aspx

Potential restrictions on longer-term investments

The provision of project finance and long-term financing generally will be affected by the Basel III rules on capital and liquidity/margining requirements, including the impact on the management of associated risks through financial instruments such as interest rate swaps.[13]

Concerns have also been expressed about the availability of longer tenor derivatives to hedge currency and interest rate risks on longer-term loans. The credit valuation adjustment charge

13 The Liquidity Coverage Ratio and the Net Stable Funding Ratio will impact on the availability of long tenor project finance. Basel III Credit Valuation Adjustment will also affect the availability of long-dated interest rate swaps.

required by Basel III materially increases the required capital for OTC derivative trading activities. These requirements need to be kept under review to ensure long-term finance.

It is expected that the ability of institutional investors to assume a greater role in the long-term finance market will take time and will not happen in a uniform manner across different market segments or regions. Factors such as legal and regulatory regimes, insurance and banking prudential standards and high capital charges for long-term assets held by insurers, are likely to have an impact on the willingness of investors to engage.[14] It appears that high capital charges for long-term assets held by insurers may unnecessarily reduce their incentive to investing in infrastructure debt.[15]

Also, the appetite of investors can also be impacted by concerns about corruption in public procurement processes. This could be addressed by governments ensuring that financial contracts for significant infrastructure projects include integrity covenants which deal with anti-corruption obligations and compliance programs.

It is also important that the existing work of international bodies on capital deepening in emerging markets is co-ordinated and focused to maximise these markets' development.

Attracting private sector investment

Governments should ensure that they have the right environment for maximising private sector investment by:

- Providing a safe and resilient financial system to instil confidence in investors
- Establishing open and transparent financing processes for public investments
- Fostering open and transparent public procurement processes and mechanisms to keep corruption out of the system
- Facilitating risk-sharing with the private sector by developing financial instruments that align risk and return profiles with investor needs
- Encouraging long-term investment by ensuring adequate returns to investors
- Examining accounting and taxation treatments of projects to ensure that unnecessary additional risks are not imposed
- Examining the design of retirement income products to better match appetites of fund beneficiaries with the long-run returns offered by infrastructure investments.

Value

Facilitating greater investment in infrastructure could increase total value of investment by $57 trillion.

14 World Bank, *Long-term investment financing for growth and development*, February 2013; World Economic Forum, Infrastructure Investment Policy Blueprint, February 2014.
15 International Institute of Finance and SwissRe, February 2014, *Infrastructure Investing It Matters*, http://iif.com/download.php?id=3o2DKg06OFY=

Actions

Ref	Action
FG4A	Governments should develop infrastructure markets that are attractive for longer-term investors through greater transparency and accountability of infrastructure processes. Governments should facilitate risk sharing with the private sector through the development of capital market financing instruments that align risk and return profiles with investor needs.
FG4B	The FSB, the BCBS and the International Association of Insurance Supervisors should reconsider the effects of insurance regulations (Solvency 2) and the banking standards so that they do not impose unnecessary restrictions on potential longer-term investors.
FG4C	The OECD and World Bank should develop mechanisms to finalise a generally accepted best practice framework for infrastructure investment, dealing with legal and operational requirements, and standardise issuing procedures and due diligence processes for infrastructure-related capital instruments.

Removing impediments to trade finance

Summary

Recommendation	Removing impediments to trade finance flows
Reference	FG5
Owner	BCBS, FATF, FSB, WTO
Timing	December 2015
Value	US$1.5 trillion
KPI	Trade flows in / with EMEs
Current (Target)	~38% of total trade flows in 2012 (42% by 2017)

Context

According to the Bank for International Settlements (BIS), trade finance directly supports about one third of global trade with letters of credit covering about one sixth of total trade. The importance of trade finance in emerging markets is even higher.[16] Trade finance is inherently of a low-risk nature. It is diverse, smaller in value, short tenor, self-liquidating and often fully or partly collateralised.[17]

In a world of increasingly fragmented value chains spanning across developed and emerging markets, the availability of trade finance, and the ability of banks to facilitate international trade through linkages between different banks across jurisdictions, is fundamental to ensuring that international trade remains as a major driver of recovery, growth and prosperity.

There is a concern that anti-money laundering regulation and risk assurance measures can have unintended consequences of making it difficult and costly for banks to maintain their existing trade relationships and challenge their ability to support global value chains. The problem is felt most acutely in high-risk emerging-market jurisdictions where the cost of relationships with banks in such jurisdictions can be significantly increased.

There would be benefit in improved compliance and certainty if specific guidance notes on trade finance were added to the FATF 40 recommendations. Financial institutions would be able to adopt a standard, risk-based approach acceptable to the regulators for establishing a trade-transaction-only relationship with another financial institution.

The impact of global rules on trade finance

The BCBS examined the treatment of trade finance under Basel III in 2012 and 2014. Amendments were made to reduce the capital requirements for trade financing transactions.

The B20 is still concerned about the impact of the new capital and liquidity reforms on its ability to provide trade finance in a cost–effective fashion. The recent changes to the leverage ratio are welcomed, however, further steps could be taken to address these issues.

16 Asia-Pacific "accounts for more than half of the L/C-related as well as overall trade finance exposures, while Europe accounts for one quarter, and North America, Latin America, Africa and the Middle East each for around 5–10%. Committee on the Global Financial System, January 2014, Trade Finance: Development and Issues, (http://www.bis.org/publ/cgfs50.pdf).

17 International Chamber of Commerce, April 2013, Global Risks: Trade Finance Report, (http://www.iccwbo.org/News/Articles/2013/New-ICC-report-says-low-risk-trade-finance-not-to-be-feared/). See also Fung Global Institute and Stamford Advisory, *Basel III and Asia*, 2013.

When implementing Basel III, European policy-makers have, for example, agreed upon a package of reforms that recognises the low-risk nature of trade finance products and ensured a more proportionate capital and liquidity treatment. Other jurisdictions should consider this approach. The B20 encourages national jurisdictions to implement Basel III in a harmonised and consistent way recognising the low-risk, short-term tenor of trade finance.

In emerging market economies, local banks account for the bulk of the bank financing in support of trade. There is concern that the traditional role of support for international trade through bank-intermediated products will be restricted due to the higher capital and liquidity rules. To some extent the real effects of Basel III are being masked by the current abundance of liquidity.

Arguably, the new regulatory requirements result in an overly conservative treatment of trade finance assets and obligations. While recent changes to the Basel III requirements have recognised the low risk of trade finance, it appears that SMEs and companies in emerging economies may face difficulties in accessing trade finance.

The B20 has reviewed the impact of the new global rules for banks on trade finance through customer case studies which provide real-life examples of any adverse impact from regulations on trade finance, commodity trading and correspondent banking. In terms of trade finance, the review found a significant increase in the quality and amount of collateral required, as well as cost increases in guarantees for all key trade-flow linked products. In emerging markets, the review indicates trade flows are reducing and prices are increasing.

The costs of providing currency and interest rate hedging that international trade requires has increased significantly. Credit valuation adjustment, where counterparty credit risk is valued, priced and hedged, has risen for smaller companies since the counterparty risk is higher. In terms of correspondent banking, the B20 review found a consistent view that anti-money laundering suspicious activity reporting processes are ineffective as an enforcement tool and that the anti-money laundering regulations have significantly increased the costs of doing business.

Commodities markets

The B20 supports the need for transparency in the commodities markets as a whole and, in particular, in the activities of major commodity exchanges such as London Metal Exchange to enhance overall rules consistency. The B20 supports measures aimed at moving trading into clearing systems and requiring reporting to trade repositories.

However, it appears that in terms of commodity trading, the new OTC requirements have led to commodity operations being disproportionally impacted by the broadness of the regulations.

Consideration needs to be given to standardisation of requirements for capital required by banks for physical trades and intra group trades. At present there is a lock–up of capital for physical trades and intra group trades (e.g. swaps) as they are treated the same as proprietary trades in terms of capital requirements. This seems unnecessarily restrictive. There has been a decrease in attractiveness of longer-term OTC products due to higher capital requirements, pressuring financial institutions to increase prices or exit from the market.

Given the nature of trade finance, the B20 suggests regulators should consider whether trade finance should be treated differently from other banking products.[18]

18 Consideration could be given to a new Asset Value Correlation treatment for trade finance or the development of a specific loss curve for trade finance products, better reflecting the low-risk nature of trade finance transactions.

Case Study: Mainstream Asia-Pacific pharmaceutical company

"We had an explicit conversation with the bank Relationship Manager, and were told that capital burden on Trade Finance activities has triggered massive repricing and collateralisation. We 'swallowed' that since we had no time to find another bank given the long on-boarding process and the need to rapidly keep the business going."

- Stricter collateral requirements for all key trade-flow linked products has led to an increase in collateral from ~10% to ~50% of value, while performance bonds are all fully collateralised.
- Cost of guarantees has increased up to 50%, with ~3-3.25% fee vis-à-vis ~2% previously applied.

Value

Removing impediments to trade finance has the potential to increase trade flows within and between emerging markets by 9 per cent per annum or US$1.5 trillion by 2017.

Actions

Ref	Action
FG5A	The World Trade Organization should conduct a global study of the impact of new financial crime compliance standards on global trade flows with special focus on SMEs and the emerging markets. Such assessment is needed to find a balanced approach between the need to combat financial crime and the global development agenda.
FG5B	The FSB should undertake an annual review of regulatory measures that impact on the supply and pricing of trade finance to see whether there is any need for modification.
FG5C	The FATF should establish a framework for mutual recognition of base level due diligence standards requirements and establish standard procedures for "trade transactions only" between banks which streamlines anti-money laundering requirements.

Value calculation methodology

The task force assumed that a well functioning regulatory system, with improved coordination and adjustments to some distortions, could contribute to increased global business activity. The overall approach was to quantify the value at stake if the proposed improvements were not made to the regulation of financial markets. For example, this amounts to saying that at current course and speed, global lending is forecast to grow 5 per cent. Other metrics that were used to estimate the value at stake were: in relation to EMEs, GDP growth per annum; for financial inclusion, global cross-border trade flow growth per annum; annual global infrastructure spending; and for trade finance, growth in trade flows from or in EMEs per annum. The recommendations by the task force are required to at least sustain this level of growth as currently regulation is dampening aspects of business activity.

Recommendation 1 – Improving global regulation of markets

The working group assumed that a healthy regulation system, with improved coordination and a few corrections to some 'distortions' could improve the global unfolding of financial markets. Since Banks underpin global growth by lending to corporates (for investments, working capital financing, etc.) and to families (for home buying of consumption financing) the simplest indicator tracking the health of the financial system and how it underpins the global GDP growth is the global volumes of lending. GDP growth is typically one third of the lending growth on a yearly basis. Value at stake of 5 per cent annual growth in global lending volumes from 2013 to 2017 was generated via the following sources:

- 2013 lending volumes sourced from data from Central Banks and National Statistical organizations and collated. This indicator is calculated by summing up the data coming from central banks and National Statistical organizations, hence robust and easy to be tracked.
- 2017 projections informed by McKinsey & Company based on nominal GDP growth (+6.7% CAGR 2013-20), investment flows, and likely structural and cyclical changes impacting GDP growth. This has been carried out by leveraging a proprietary macroeconomic model that creates a correlation between expected GDP growth and expected growth of lending through a multi-year non-linear regression of these two variables. Furthermore the model captures other variables impacting lending growth such as: investments flows and cyclical changes of the industry structure in key countries (again calculated through a non-linear regression).

Recommendation 2 – Greater recognition of emerging market economics

The key indicator used to demonstrate the importance of emerging economies has been the absolute amount of real GDP of emerging markets over the global GDP. This ratio clearly spells out how important are the emerging economies. Value at stake of 11 per cent annual growth from 2013 to 2017 is sourced from the Economist Intelligence Unit (EIU) - a sister concern of The Economist magazine that consolidates data from country specific central authorities.

Recommendation 3 – Facilitating financial inclusion

The metric used to dimension the value at stake here is growth in global cross-border trade flows. Value at stake of 7 per cent annual growth from 2012 to 2017 is also sourced from the EIU.

Recommendation 4 – Facilitating greater infrastructure spending

The metric used to dimension value at stake is yearly spend on infrastructure.

Value at stake is dimensioned by highlighting the gap between current infrastructure spending and required infrastructure spending. Data for this obtained from McKinsey Global Institute, a macro think-tank of McKinsey & Company based on countries' infrastructure gap. The value has been estimated by summing the project pipeline currently available on a global level adjusted by converging the infrastructure spend as a percentage of GDP of different countries. Countries have been aggregated into clusters by stage of development and for each cluster a 'target' value of infrastructure spend has been defined (as a percentage of GDP).

Recommendation 5 – Removing impediments to trade finance

The metric used to dimension value at stake is trade flows among or with emerging markets (it is a subset of the data set used for Recommendation 3). Value at stake of 9 per cent annual growth from 2012 to 2017 is also sourced from the EIU.

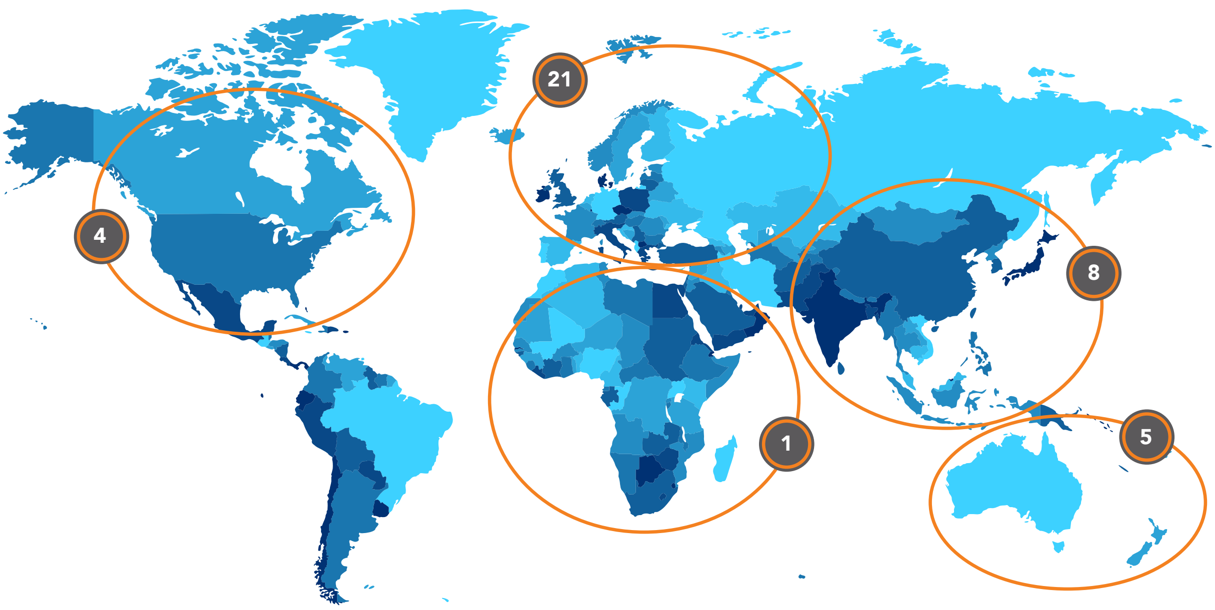
Taskforce schedule and distribution of members

Schedule of meetings

#	Date	Location	Theme
1	13 Feb 2014	Teleconference	Introduction to the B20 and G20 process
2	2 Apr 2014	Teleconference	General discussion on Taskforce direction and recommendations
3	19 May 2014	Teleconference	Discussion on Position Paper and specific Taskforce recommendations
4	12 June 2014	Teleconference	Finalisation of Taskforce recommendations
5	17 - 18 Jul 2014	Sydney	B20 SUMMIT

Distribution of members

Country	#	Country	#	Country	#
Argentina	-	India	3	Saudi Arabia	-
Australia	5	Indonesia	-	South Africa	1
Brazil	-	Italy	1	Turkey	2
Canada	-	Japan	2	United Kingdom	1
China	1	Korea	-	United States	4
France	7	Mexico	-	European Union	4
Germany	1	Russia	4	Other	3



Taskforce members

Title	Given Names	Family Name	Position	Organisation
Mr	Timothy	Adams	President and CEO	Institute of International Finance
Mr	Hasan	Akcakayalioglu	TUSIAD Board Member and B20 Working Group President	TUSIAD
Mr	Yusuf	Alireza	CEO	Noble Group
Mr	Stephen	Almond	Global Chairman	Deloitte
Mr	Mark	Burrows	Managing Director & Vice Chairman, Global Investment Banking	Credit Suisse
Mr	Edouard-François	De Lencquesaing	Deputy CEO	Paris EUROPLACE
Mr	Fabrice	Demarigny	Global head of capital markets activities	Mazars
Mr	Oleg	Deripaska	Chief Executive Officer, Chairman of the Management Board	UC RUSAL
Mr	Dmitry	Dmitriev	Managing Director	VTB Bank
Mr	Juergen	Fitschen	Co-Chief Executive Officer	Deutsche Bank AG
Mr	Pierre	Gattaz	President	Mouvement des Enterprises de France
Mr	Federico	Ghizzoni	CEO	UniCredit
Mr	Gary	Gill	Partner in Charge, Forensic	KPMG
Mr	Herve	Guider	General Manager	EACB
Mr	Piyush	Gupta	CEO	DBS Group
Mr	Jeffrey	Hardy	Director	ICC G20 CEO Advisory Group
Mr	Juan Rodriguez	Inciarte	Executive Board Member	Banco Santander
Mrs	Gail	Kelly	CEO & MD	Westpac Group
Mr	Andrey	Kostin	Chairman and CEO	VTB Bank
Mr	Jean	Lemierre	Advisor to the Chairman	BNP PARIBAS
Mr	Gary	Litman	Vice President, International Strategic Initiatives	United States Chamber of Commerce
Mr	Anand Gopal	Mahindra	Chairman and Managing Director	Mahindra & Mahindra Ltd.
Mr	Luca	Martini	Director	Mckinsey
Mr	Robert	Milliner	Australia B20 Sherpa	B20 Australia 2014
Mrs	Catherine	Minard	International Director/B20 MEDEF Sherpa	Mouvement des Enterprises de France
Mr	Azman	Mokhtar	Managing Director	Khazanah Nasional Bhd
Mr	Masayuki	Oku	Chairman of the Board	Sumitomo Mitsui Fiancial Group
Mr	Frederic	Oudea	Chairman & CEO	Société Générale
Ms	Eva	Piera	Global Head of Institutional Affairs	BBVA
Mr	Oleg	Preksin	Executive Vice President	RSPP
Dr	Ajit	Ranade	Chief Economist	Aditya Birla Group
Mr	Peter	Sands	Group Chief Executive	Standard Chartered plc
Mr	Janmejaya	Sinha	Chairman-Asia Pacific	The Boston Consulting Group
Mr	Michael	Smith	CEO	ANZ
Mr	Andrew	Smith	Country Chair of Shell in Australia	Shell Australia Limited
Mr	Zola	Tsotsi	Chairman	Eskom Holdings SOC Limited
Mr	Marcus	Wallenberg	Chairman of the Board	SEB
Mr	Yoshihiro	Watanabe	Managing Director	Institute for International Monetary Affairs
Mr	Zafer Ali	Yavan	Secretary General	Turkish Industry & Business Association
Mr	Serdar	Yesilyurt	Director, Representation office to the European Union	Confederation of Businessman and Industrialists of Turkiye

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