

To G20 Finance Ministers and Central Bank Governors

Financial Reforms – Update on Progress

I reported in February on the priorities, agreed by G20 Leaders in St. Petersburg, for substantially completing the core of the G20's programme of fundamental reform of the global financial system during the Australian Presidency. We are on-track to deliver for the Brisbane Summit, but difficult decisions remain to be taken in three particular areas where the support of Ministers and Governors is essential:

- Ending too-big-to-fail;
- Transforming shadow banking to transparent and resilient market-based financing; and
- Making derivatives markets safer.

In addition, I highlighted in February the need for the G20 to develop an approach to financial regulation that went beyond the Brisbane Summit. At the heart of that approach are commitments to:

- Peer reviews and impact assessments;
- Outcomes-based approaches to resolving cross-border issues; and
- Enhanced co-operation to avoid domestic measures that fragment the global system.

Consistent with building the mutual confidence and trust to underpin that approach, a review of the representation of jurisdictions on the FSB has begun.

This letter summarises the progress to complete the programme of reform for the Brisbane summit, begins to look ahead to plans for implementation beyond Brisbane, and summarises the initial findings of the FSB review of representation.

PRIORITIES FOR COMPLETING REFORMS BY THE BRISBANE SUMMIT

1) ENDING TOO-BIG-TO-FAIL

As the G20 Leaders directed, it is essential that systemically important institutions can be resolved in the event of failure without the need for taxpayer support, while at the same time avoiding disruption to the wider financial system. The expectation that systemic institutions can privatise gains and socialise losses encourages private sector risk-taking and can be ruinous for public finances.

Gone-concern loss-absorbing capacity

In St Petersburg, Leaders called on the FSB to develop proposals by the end of this year on the adequacy of global systemically important financial institutions' loss-absorbing capacity when they fail.

This 'gone-concern loss-absorbing capacity', or GLAC, is vital for home and host authorities to have the ability and confidence, as well as for private markets to recognise, that systemically important banks can be resolved safely, without the use of public funds, while taking account of differences in national resolution regimes.

The FSB intends to submit a proposal to the Brisbane Summit. Members are making progress, but your support is needed for the further intense work ahead of the Brisbane Summit on the following three issues:

- The criteria that bank liabilities should meet to be considered as GLAC. Eligible liabilities should be available to incur losses at the point of resolution in a manner consistent with the creditor hierarchy. Authorities are examining a wide range of liabilities, including common equity in excess of regulatory requirements, which could meet these criteria.
- The appropriate amount of GLAC that systemically important banks should hold. If it can be agreed, a common minimum GLAC standard for all globally systemic banks will increase confidence among home and host authorities that there is a minimum amount of resources available in resolution to absorb losses.
- Where in the structure of banking groups that GLAC should be held. We are examining a range of options given diverse banking models, but the necessary requirement is effectiveness. The location of the GLAC will need to reflect the resolution strategy for each firm, so this work will draw on the findings of the Resolvability Assessment Process for individual global systemically important banks that will involve both home and host authorities.

After the Brisbane Summit, the proposal will be:

- Submitted for public consultation and be subject to a comprehensive quantitative impact assessment;
- Applied to the Resolvability Assessment Process for each of the current 29 global systemically important banks, before being finalised in 2015; and
- Based on these processes, adjustments to the GLAC framework would be made, as appropriate.

Cross-border resolution actions

The resolution of cross-border banks must be supported by contractual or statutory approaches for cross-border recognition of resolution actions, including temporary stays on close-out and cross-default rights in financial contracts when a firm enters resolution, and bail-in of debt issued under foreign law. For the Brisbane Summit:

- The FSB is working with the financial industry to establish a contractual approach to temporary stays.
- Your support is needed to ensure that national authorities are empowered to co-operate fully with their counterparts in other countries, including by recognising foreign

resolution actions and ensuring that debt issued under foreign law includes contractual recognition provisions so that bail-in is effective in a cross-border context.

Other measures to end too-big-to-fail

- The FSB has this month published a progress report on its work to strengthen supervisory intensity and effectiveness.
- FSB Members have reviewed an interim assessment, produced by the FSB in collaboration with the IMF and OECD, of the cross-border consistency and global financial stability implications of planned or implemented domestic structural banking reforms in individual jurisdictions. Many of these measures help address the too-big-to-fail problem, but also have impacts on financial institutions and markets in third countries. That work will be developed and the FSB will report on this to the Brisbane Summit.
- The International Association of Insurance Supervisors (IAIS) will finalise for the Brisbane Summit a Basic Capital Requirement on which higher loss absorbency for global systemically important insurers will be built. This work is progressing well.

2) TRANSFORMING SHADOW BANKING

The FSB is working to strengthen the oversight and regulation of shadow banking according to the roadmap agreed by Leaders at St Petersburg. The FSB has:

- Agreed an information-sharing process to support implementation of the policy framework for oversight and regulation of shadow banking entities other than money market funds;
- Developed further the policy framework to address financial stability risks associated with securities financing transactions. This follows a review of the results of the public consultation and a further comprehensive quantitative impact study. An implementation timetable for the policy recommendations in this area has been agreed and will be published.
- In addition, the BCBS has finalised its supervisory framework for large exposures, to be published shortly, and risk-sensitive capital requirements for banks' investments in equity of funds, to mitigate spill-over effects between banks and shadow banking entities.

Ahead of the Brisbane Summit:

- The FSB will start information sharing among authorities in May and will report initial findings.
- The framework for haircuts and haircut floors in repo and securities financing transactions will be finalised.

After the Brisbane Summit:

- The FSB will launch a peer review on national implementation of the high-level policy framework in 2015.

3) MAKING DERIVATIVES MARKETS SAFER

National implementation of agreed G20 objectives for OTC derivatives reform is overdue, but substantial progress is being made in addressing the remaining cross-border issues.

- The BCBS has finalised, and will publish ahead of our meeting, capital standards for the treatment of banks' exposures to central counterparties that will clear OTC derivatives trades.
- The OTC Derivatives Regulators Group (ODRG) has provided a report setting out the remaining known cross-border implementation issues relating to OTC derivatives reforms.

Ahead of the Brisbane Summit:

- The ODRG will provide further reports in September and November on how it has addressed, or intends to address, the identified cross-border implementation issues.
- The FSB will publish a report in September on the established processes in each jurisdiction to enable deferral to the OTC derivatives rules of others where these achieve similar outcomes.
- The FSB will publish a report in May on approaches to aggregating and sharing derivatives data amongst authorities. It is crucial that the data that will become available under new trade reporting rules can be used by authorities to monitor global financial stability, even though they will be reported to multiple trade repositories.

STRENGTHENING EFFECTIVE CO-OPERATION: FSB REVIEW OF THE STRUCTURE OF REPRESENTATION

As I noted in my February update letter, the G20 can now begin to look further ahead to how, collectively, members will regulate and supervise the global system in a way to build mutual confidence and trust, and thereby realise fully the benefits of an open, integrated system. Commitment from, and support of, Ministers and Governors is needed to do so. The FSB can play a role in establishing that mutual confidence and trust by reviewing the structure of its representation.

The FSB Plenary has reviewed a survey of members' views and discussed a range of options. Some clear views have begun to emerge:

- There is little support for moving to a constituency-based membership, as this would be at odds with the underlying FSB membership being of institutions rather than jurisdictions and would make discussions more rigid.
- There was also little support for considering the exit of any member jurisdiction, or to consider making room for new types of national authorities beyond the existing membership of ministries of finance, central banks, supervisors and regulators.
- Members have stressed the importance of maintaining both effectiveness and the representativeness of the FSB and regard the current number of 70 members as the upper limit consistent with that.
- The weight of opinion is in favour of keeping objective criteria of economic and financial size for determining membership and seat allocation.
- At the same time, to strengthen and broaden engagement, members agree to use the flexibility that exists within the FSB's rules to enable relevant authorities within

jurisdictions to participate in, or be informed of, the policy work that takes places in the FSB's standing committees and working groups.

The FSB will continue to work on the review, with the goal of discussing a final report from the review at its September Plenary meeting and presenting it to the Brisbane Summit.

I look forward to discussing these issues with you at our upcoming meetings and to working together to substantially complete the core of programme of reform.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'M. Carney', with a long, sweeping underline that extends to the right.

Mark Carney