FSB´s second annual Report on Implementation and Effects of the G-20 Financial Regulatory Reforms. October 2016.

The **Financial Stability Board**, hereinafter -FSB-, published August 31, 2016, its **2nd Annual Report** with the purpose of bringing the attention to the G20 on the implementation progress and the effects of its **"Programme of Financial Regulatory Reforms"** to address the fault lines that caused the latest financial crisis.

The main objective of such reform is to increase the resilience of the global financial system while preserving its open and integrated structure. Hence, the program is designed to address 4 tasks:

i) Building resilient financial institutions.
ii) Ending *"too big-to-fail"*.
iii) Developing safer derivatives markets.
iv) Transforming *shadow banking* into resilient market-based-finance.

The report begins with an assessment on the implementation progress of the reform programme. Hereafter, it analyses the reform´s impact on two core areas: resilience of the global financial system, and intermediation. Finally, the report expounds how the FSB has monitored 3 areas in 2015: market liquidity, effects of reforms on emerging markets and developing economies (EMDEs) and the development of an open and integrated global financial system.

Regarding the **regulatory implementation process** concerning the abovementioned matters, the report states:

- In relation to the **resilience of the financial institutions**. The FSB report deems that 24 Member States have adopted, in their jurisdictions, the core elements of Basel III regarding risk based capital and liquidity requirements –*Liquidity Coverage Ratio*, LCR-; as well as the new requirements and methodologies concerning rules on higher loss absorbency requirements for global systemically important banks. Even 95 states, which are non-members to the Basel Committee on Banking Supervision, have adopted such definitions (capital and LCR, Basel III definitions). Notwithstanding the above, the report also states six EU Member States are not complying with Basel *"risk-based capital rules*". Conversely, jurisdictions are now moving on to implementation of the leverage ratio and the *Net Stable Funding Ratio* -NSFR-, which are due to come into force in 2018. Actually, 80% of large internationally active banks report meeting the fully phased-in minimum liquidity requirements -LCR and NSFR-. Nevertheless, some States have reported delays when implementing the Basel principles, as the counterparty credit risk, capital requirements required to central counterparties or the revised Pilar III structure. Finally, almost all FSB jurisdictions have fully implemented the FSB Principles and Standards for Sound Compensation Practices.

- In relation to ending **“too-big-to-fail”**. Many measures have been adopted, as the implementation of *Higher Loss Absorbency* or the improvement of supervisory frameworks. The report finalizes by stating the implementation of such measures is pretty advanced for globally systemically important banks, though some banks have had to report they could not meet the deadline for compliance set for 2016 on *risk data aggregation* and *risk reporting*. Large internationally active banks are also adopting strategies which enable the development of “*total loss-absorbing capacity*” -TLAC-. On the other hand, resolution planning is not enough implemented, especially in the insurance sector. In fact, some jurisdictions have still not adopted specific and very basic measures, as those related to “*bail-in*”.

- In relation to “**Making Derivatives Markets Safer**”. The FSB assessment determines, on the one hand the implementation of derivatives transaction reporting is currently in force in 19 countries, and on the other hand, higher capital requirements are already being required for non-centrally cleared derivatives in 20 countries, covering over 90% of OTC of their relevant market. Additionally, since September 2016, clearing requirements are adopted in 10 jurisdictions, mainly on interest rate derivatives. Though, the report also admits some countries are not on track with the *variation margin requirements*, nor have most jurisdictions developed enough platform trading frameworks.

- Finally, another challenge is transforming **shadow banking into resilient market-based finance**. To that end, the FSB has designed a policy framework for oversight and regulation which *shadow banking entities* must abide. Among such measures, and, in order to ensure that spill-overs of risks to the banking system are prudentially mitigated, jurisdictions are implementing the risk-based capital requirements for banks´ investments in the equity of funds, as of 2017. As for the FSB´s “*peer review*” outcome, it reveals the implementation is still at an early stage, as is also the case of the FSB´s recommendations on securities financing operations.

Regarding the **overall effects of reforms**, the report states,

- The objective pursued has been attained, which consists of a **global financial system considerably stronger than before the crisis**, mainly by developing better quality capital buffers, largely through retained earnings. They currently have lower leverage. However, banks have less value in the market and keep on adapting their frameworks and business models to the new scenario, preferring to focus more on retail banking. Additionally, the report highlights realms, yet to work on TLAC and resolution of central counterparties.

- Despite banks having to meet higher capital requirements, they have been able to **maintain the overall provision of credit to the real economy**, boosting market-based lending, all of which has come to fruition thanks to exceptionally accommodative monetary policies during the crisis. Additionally, non-bank financial intermediation now represents 40% of total financial system assets in 20 jurisdictions and the euro area. Growth was mostly found on trusts and money market (fixed income and other funds).

- Finally, the reform´s adopted measures have significantly contributed to alleviate market risks, such as securitization regulation or the obligation to clear standardised derivatives in central counterparties. Even so, the FSB admits there is still a long road ahead in market infrastructures, market-based financing and asset management.

Furthermore, **last year´s report identified three areas to monitor**, and concluded:

Market liquidity. The FSB reports a number of changes which are taking place in the markets that may impact liquidity, as the role of the asset management industry in fixed income markets given it has grown significantly since the financial crisis. Also, regulatory reforms to make banks more resilient have increased the costs of dealer banks´ market-making activities, and technological changes with growth in electronic trading. Nevertheless, the conclusion reached comes through admitting there is no conclusive evidence that allows the FSB to affirm that there is less abundant liquidity in normal times. Even so, it recognizes less depth for some sovereign and corporate debt markets, as well as decreasing trading venues in the repos market´s. The FSB will focus on analysing market liquidity resilience under stressed market conditions. In any event, the report expounds reforms have managed to minimize what possibly is a deteriorating market liquidity scenario.

Effects of reforms on EMDEs. The reform´s main impact in such countries is proven with global banks reducing their presence in EMDE markets. On the other hand, a longer conformance period was permitted for G-SIBs headquartered in EMDEs, given the impact of the TLAC on EMDEs.

An open and integrated global financial system. The report affirms that reforms have helped avoid significant retrenchment and market fragmentation, though it admits the trend seems to be that of a "*more stable-locally-funded lending*" taking place. Furthermore, the global integration of securities markets continues to grow. Additionally, sustainable cross border financing performed by non-financial institutions via issuance of international bonds seems to be what helps the market integration soar, as well as cross-border holding of securities and more global financial infrastructures. Finally, the report highlights reforms affecting OTC derivatives have no negative impacts on such markets.

Additionally, the report affirms the G20 will keep on backing FSB´s work in adopting the following measures:

i) Sharing information
ii) Any measures which may be deemed necessary in order to foster foreign jurisdictions resolutions´ efficacy.
iii) Eliminate legal barriers regarding communication of OTC derivatives to the trade repositaries.
iv) Eliminate barriers which deny the Authorities access to data stored in the trade repositaries.
v) Eliminate legal, data and capacity barriers concerning data and means which hinder the implementation of the adopted measures.

For further information: FSB's Second Annual Report on the Implementation and Effects of the G-20 Financial Regulatory Reforms.