INTOSAI Working Group on Financial Modernization and Regulatory Reform

6th Knowledge Sharing Steering Committee Meeting

Cairo, Egypt

14 & 15 October 2014

Mr. Chairman,

Fellow Colleagues,

Ladies and Gentlemen,

At its 63rd meeting in 2012, the INTOSAI Governing Board established the Working Group on Financial Modernization and Regulatory Reform. The Working Group is a transformation of the Task Force on the Global Financial Crisis (established in the fall of 2008 to examine issues related to the global financial crisis) into a permanent group. In approving the transformation, the Governing Board recognized that the INTOSAI community must continue to enhance its expertise and capabilities to meet the challenges associated with overseeing national and global financial systems.

Under its terms of reference, the Working Group aims to assist SAIs in addressing these challenges by (1) developing tools and knowledge-sharing opportunities for evaluating national reforms, (2) establishing mechanisms for sharing information on the progress of reforms between INTOSAI and international bodies, and (3) systematically tracking information of reforms at national and international levels. The Working Group has organized its members into three subgroups to meet these objectives, with China, Canada, and the United States chairing the subgroups, respectively.

The Working Group’s 25 members are Austria, Brazil, Canada, Chile, China, Cyprus, Estonia, Finland, France, Hungary, Indonesia, Italy, Republic of Korea, Mexico, Morocco, Netherlands, Poland, Russia, Saudi Arabia, Spain, Sweden, United Kingdom, United States, Venezuela, and the European Court of Auditors. We welcome the participation of interested parties that are not members of the Working Group and invite all interested SAIs to join the Working Group.

My comments today focus on (1) the progress made by the Working Group to date and (2) the status of international financial regulatory reform efforts. Information on the status of reform efforts is based on the Working Group’s audit work and research.

**Working Group’s Progress and Next Steps**

Overview of the Working Group’s Progress

Over the past year, the Working Group has made solid progress achieving its objectives. The three subgroups—aligned with the Working Group’s objectives—held periodic teleconferences throughout the year to develop and begin to implement their work plans. For example, subgroup 1 completed and summarized the results of a survey of the Working Group members concerning their financial market audit authority. Subgroup 2 identified relevant international bodies and established relationships with the International Monetary Fund (IMF) and the Basel Committee on Banking Supervision (Basel Committee). And Subgroup 3 reviewed and reported on the implementation progress of key international financial reforms, such as Basel III capital standards. In addition, the Working Group held its first in-person meeting in late spring, providing an opportunity for its members to get to know each other and discuss their audit work. Finally, the Working Group continued to monitor the progress being made to implement the international financial regulatory reforms developed by the Group of Twenty (G20) and other international bodies. We present a summary status report below.

As noted, in May 2014, the Working Group held its first in-person meeting at the Government Accountability Office (GAO) in Washington, D.C., and members from 13 SAIs attended. The meeting included (1) discussions of SAI audit work involving financial market and institution oversight, (2) subgroup breakout sessions to discuss progress made and next steps, and (3) presentations on financial regulatory reforms by officials from IMF, think tanks, and academia. (Minutes of the meeting are available on INTOSAI’s website.)

The subgroups also conducted teleconferences throughout this past year to share information and advance on their objectives. Below summarizes the progress each subgroup has made to date and planned next steps.

Progress and Next Steps for Subgroup 1: Audit Tools

Under the China SAI’s leadership (National Audit Office), subgroup 1 has made progress developing tools and knowledge sharing opportunities (objective 1).[[1]](#footnote-1) It completed and summarized the results of a survey of the Working Group members concerning their financial market audit authority. Nineteen SAIs completed the survey, and the key findings include the following.

* All but one of the SAIs have the authority to conduct financial audits of the finance minister and central bank. In addition, most SAIs have the authority to conduct some types of performance audits of the finance minister, central bank, and financial regulators. In contrast, only a few SAIs have the authority to audit financial institutions, in particular when those institutions are part of the state. Finally, most SAIs have the authority to audit institutions responsible for consumer protection. The survey found that some SAIs have gained additional audit authorities following the crisis.
* Seven SAIs have conducted audits of the processes and effectiveness of financial regulatory reforms. In addition, other SAIs have conducted performance audits of regulators that included some aspects of regulators’ oversight of financial system regulation and reform.
* Four SAIs have conducted audits of financial institutions, and several SAIs have conducted related work to assess the risks posed by financial markets to public finances.
* In their survey responses, SAIs identified the following tools that they wanted to help them conduct their audits: (a) criteria and methodologies to measure that reforms are effective and appropriate to the problem, (b) methodologies to identify regulatory weaknesses or gaps, (c) best practices from other SAIs’ audit activities, and (d) tools to evaluate the impact of financial reform on financial markets (e.g., impact of nationalization).

Planned next steps for Subgroup 1 over the coming year include

* finalizing a summary report outlining SAIs’ authorities, experience, methodology, and available guidance for oversight of the financial system;
* compiling information on the methodologies used by the subgroup’s SAIs to oversee the financial system; and
* starting work to identify tools and guidance to share among the SAIs.

Progress and Next Steps for Subgroup 2: Networking with International Bodies

Under the Canada SAI’s leadership (Office of the Auditor General), subgroup 2 produced a report on the development, implementation, and monitoring of international financial reforms—in part to identify international bodies with which to network (objective 2).[[2]](#footnote-2) The report identified more than 15 international bodies involved in financial reform efforts, and the subgroup is seeking initially to establish relationships with the following four based on their significant role in the reform efforts.

* *The Financial Stability Board (FSB)* was established by the G20 in 2009 to coordinate at the international level the work of national financial authorities and international standard-setting bodies in order to develop and promote the implementation of effective regulatory, supervisory, and other financial sector policies. FSB has instituted a framework for monitoring implementation of the G20 financial reforms and reports periodically to the G20 about standards development and implementation progress.
* *The Basel Committee* is the primary global standard-setter for the prudential regulation of banks and in 2010 issued Basel III—a comprehensive set of reform measures to strengthen the regulation, supervision, and risk management of the banking sector. The Basel Committee works with FSB, of which it is a member, and other international standard-setting bodies to address financial reform issues within its mandate.
* *IMF* is an organization of 188 member jurisdictions. IMF conducts not only surveillance of its members’ financial sectors at the bilateral and multilateral levels but also research and analysis of macroeconomic and financial issues. The G20 has tasked IMF and FSB with the responsibility for conducting early warning exercises to assess risks to global financial stability.
* *The International Organization of Securities Commissions (IOSCO)* sets global standards for the securities sector to protect investors, ensure efficient markets, and address systemic risks. Its members include more than 120 securities regulators. IOSCO also works with the G20 and FSB to develop standards and guidance to implement the global regulatory reforms that apply to securities markets and institutions

To date, the subgroup has contacted representatives from FSB, the Basel Committee, IMF, and IOSCO to discuss their interest in establishing a regular, ongoing dialogue with the Working Group to exchange knowledge and share information. In November 2013, GAO’s Comptroller General met with IMF Deputy Managing Director Min Zhu, and secured his support to establish an IMF-Working Group partnership and establish a point-of-contact. In September 2014, GAO’s Comptroller General met with Mr. [William Coen](http://www.bis.org/press/p140423.htm), Secretary General of the Basel Committee, who expressed his willingness to meet periodically with the Working Group and expressed interest in SAIs’ audit work related to recent financial regulatory reforms.

Planned next steps for subgroup 2 include scheduling meetings with FSB and IOSCO by the end of 2014. At these initial meetings, the subgroup will inform the international bodies about INTOSAI, generally, and the Working Group, specifically.

Progress and Next Steps for Subgroup 3: Reform Efforts

Under the U.S. SAI’s leadership (GAO), subgroup 3 is responsible for monitoring and reporting on the financial reform progress at national and international levels (objective 3).[[3]](#footnote-3) To help lay the foundation for this effort, GAO undertook a review of and issued a report on the implementation status of recent international financial reforms across various jurisdictions and challenges that uneven implementation may present. (The report is available at <http://www.gao.gov/products/GAO-14-261>.) This work included reviewing progress reports and other material issued by the G20, FSB, the Basel Committee, IOSCO, and other international bodies to document the implementation status of international financial reforms.

In sum, the G20 has positioned itself as the main international forum for reforming financial regulations. Since 2008, the G20 leaders (presidents and heads of state) have met at least annually and committed to implement a broad range of reforms designed to strengthen financial markets and regulatory regimes in order to help prevent future financial crises. They have tasked their finance ministers and international bodies with implementing the reforms. The key areas covered by the G20 reforms include banking, over-the-counter (OTC) derivatives, compensation practices, supervision of systemically important financial institutions (SIFI), shadow banking, hedge funds, securitizations, macroprudential frameworks and tools, credit rating agencies, accounting standards, and consumer protection.

Planned next steps for subgroup 3 over the coming year include

* Developing a standardized approach for reviewing, summarizing, and analyzing progress and other reports issued by FSB, the Basel Committee, and others on the implementation of the G20 financial reforms at the international and national levels;
* Working to develop criteria related to financial stability and emerging risks, as well as macroprudential frameworks, that can help SAIs target their audits in these areas; and
* Exploring whether GAO can create an intranet site to post documents and share material with the subgroup members.

**Status of International Financial Regulatory Reform**

SAIs, as allowed by their mandates, can play an important role in helping their governments—particularly their financial regulatory agencies—take steps to reduce the probability or magnitude of a future financial crisis. For example, SAIs could evaluate the appropriateness of the regulatory structure overseeing the financial sector and adequacy of the supervision. SAIs also may audit the implementation of the new international financial regulatory standards within their countries.

Importantly, such independent efforts may not only complement the peer reviews being undertaken by international bodies to assess the effectiveness of financial reforms but also help inform the G20 and other international bodies about their ongoing efforts to strengthen the international financial system.

Under its terms of reference, the Working Group will continue to monitor and report on the implementation progress of the G20 financial reforms and analyze peer reviews and other information on the implementation and effectiveness of the reforms. Ideally, this information will be useful to SAIs in planning their audits of financial regulatory agencies and reforms. Our first such effort follows.

International Bodies and National Authorities Are Implementing Financial Regulatory Reforms, but Progress Is Mixed

FSB, the Basel Committee, and other international bodies have surveyed members on the status of the various reform efforts.

* *Implementation of the Basel III reforms*: All of the Basel Committee members reported that they have adopted or are in the process of adopting the Basel III capital requirements as of March 31, 2014 (see table 1 in app. I). However, progress adopting the other Basel III requirements—the additional loss absorbency requirements for global and domestic systemically important financial institutions, liquidity coverage ratio, and leverage ratio—is less advanced and uneven.
* *Implementation of G20 reforms for OTC derivatives*: Almost all of FSB member jurisdictions reported that they have regulations in effect to implement the trade reporting and capital requirements as of April 2014 (see table 2 in app. I). In contrast, progress implementing the central clearing, exchange trading, and margin requirements is much less advanced and uneven across FSB member jurisdictions.
* *Implementation of the G20 reforms for Systemically Important Financial Institutions (SIFI)*: FSB, in consultation with others, has identified systemically important banks and insurers that will be subject to more stringent requirements (see app. I). FSB also reported that several jurisdictions have developed new or amended existing resolution regimes in line with a new international standard for resolution of SIFIs (call “Key Attributes”).
* *Implementation of other G20 financial regulatory reforms*: Implementation of the other reforms, including shadow banking, hedge funds, credit rating agencies, and accounting, vary across jurisdictions (see table 3 in app. I).
* *SAIs’ Efforts to Monitor Progress:* The Working Group has surveyed its members and learned that at least 10 have conducted audits in the last 5 years that examined aspects of progress their own countries are making in implementing financial regulatory reforms, including Austria, Canada, China, France, Hungary, Netherlands, Poland, Spain, United Kingdom, and United States. Of these, 3 reported “very good” progress on regulators’ implementation of reforms; 3 reported “good” progress; and 2, including the United States, reported “fair” progress. In addition, seven SAIs reported that they plan to undertake such audit work over the next 3 years.

Peer Reviews, SAI Audits, and Other Assessments Have Highlighted Challenges and Emerging Issues

A broad range of legal, economic, and political factors can create implementation challenges for jurisdictions. However, the failure to implement the international financial standards consistently across jurisdictions could have a number of negative consequences, such as hindering or weakening the ability of national authorities or international bodies to protect against developments affecting national and international financial stability. In that regard, FSB’s, IMF’s, and the Basel Committee’s peer reviews may be a crucial mechanism for monitoring and encouraging compliance with international financial standards (see app. II). In addition to the peer reviews, other monitoring efforts by international bodies, national authorities, and independent researchers have identified potential risks for financial stability, as well as ways to measure systemic risks. Following are some key findings and efforts of international, national, and independent bodies.

* *FSB peer review of “Key Attributes” of SIFI resolution regimes:* Although substantive progress has been made to improve resolution regimes for addressing SIFI failures, FSB noted that many home and host jurisdictions of G-SIFIs need to take further legislative measures to implement the Key Attributes fully in substance and scope–in particular, the adoption of powers for cross-border cooperation, powers to convert bondholders into equityholders, and the recognition of foreign resolution actions. In addition, FSB noted that the IMF-World Bank’s financial sector assessments indicate that weaknesses continue to exist with respect to some jurisdictions’ authority and oversight of SIFIs.
* *FSB country peer reviews:* Since 2013, FSB has conducted peer reviews of Germany, Indonesia, South Africa, the United Kingdom, and the United States. In these reviews, FSB generally raised, among others, concerns about each country’s macroprudential framework for monitoring and addressing systemic risk.
* *Basel Committee assessment of risk-weighted assets:* In its three assessments on the risk-weighting of assets by banks in Europe, the Americas, and Asia, the Basel Committee found considerable variation in risk weighted assets across the banks. For the upcoming G20 summit in November 2014, the committee is establishing a plan with actionable steps to address the variability and improve consistency and comparability in bank capital ratios.
* *SAI audits of impacts of financial reforms:* SAIs also have conducted audits focusing on the potential impacts of domestic financial reform efforts. For example, a recent GAO report examined the status and implementation challenges of U.S. financial regulatory reforms and potential remaining risks. Among other findings, the GAO report found that key aspects of new liquidation authorities and other reforms for resolving troubled financial firms have been implemented, with certain institutions having submitted required resolution plans—“living wills”— that would guide their rapid and orderly resolution in a bankruptcy, if needed. However, GAO reported that market observers noted the effectiveness of these provisions would not be known until the first large failure. More recently, federal regulators found that the most recent living will submissions by the largest U.S. financial holding companies were not credible.
* *Global risk assessments:* International bodies also have identified potential global risks in their periodic risk and threat assessments. For example, IMF’s *2014 Spillover Report* noted that as the advanced economies recover from the recent financial crisis, spillover effects of the G20 financial reforms in advanced economies could emerge. Specifically, it soon will become clearer whether the reforms have led to certain financial activities being excessively penalized; whether reduced profitability has affected certain types of financing; and whether new entrants (for example, nonbank financial institutions) are creating new risks. In addition, the World Economic Forum’s *Global Risks 2014* report cited the risk of fiscal crises as the top risk in 2014. The report noted that although emerging markets were able to recover quickly from the recent financial crisis, they remain vulnerable to credit bubbles, which can turn into financial and then fiscal crises. Advanced economies are maintaining high levels of debt, which the report notes makes them vulnerable to changes in investor confidence in governments’ ability to repay.
* *IMF and FSB’s Early Warning Exercises (EWE):* In 2008, the G20 asked IMF and FSB to collaborate on EWEs. EWE does not attempt to predict crises; rather, it seeks to identify vulnerabilities and triggers that could precipitate systemic crises and, in turn, risk-mitigating policies. IMF is tasked with investigating quantitative risks, represented by financial flows within and throughout regions, while FSB investigates regulatory failures that may create major stresses. The key output of EWE is a confidential semi-annual presentation to the IMF’s International Monetary and Financial Committee. IMF and FSB do not produce formal documents for the presentation because of the market-sensitive nature of the content. In a 2013 review of EWE, a think tank opined that EWE suffered from unclear goals, a lack of coordination, geographical separation, insufficient organizational capacity, and ad hoc procedures.
* *Individual government authorities’ financial stability analyses:* U.S. and European authorities have expressed concerns over the threat of widespread dislocation that could arise from significant changes in interest rates as many developed markets continue to recover from recessions. In addition, the U.S. Financial Stability Oversight Council identified the risk of fire sales as potentially posing financial instability in the tri-party repo market used by many financial institutions for short term funding.[[4]](#footnote-4)

**Closing Remarks**

In conclusion, I would personally like to express my gratitude to all 25 members of the Working Group for responding so willingly and capably to the demands of addressing its challenging objectives. I am grateful for their insights, expertise, and dedication in working towards meeting the Working Group’s objectives.

We, the Working Group, also thank all of you, fellow members of INTOSAI, for the insights and expertise that you have lent to this effort.

Thank you.

**Appendix I: Implementation Status of International Financial Regulatory Reforms**

The Group of Twenty (G20) has positioned itself as the main international forum for reforming financial regulations. In 2008, the G20 leaders (heads of state and presidents) held their first summit in Washington, D.C., and committed to implement reforms designed to strengthen financial markets and regulatory regimes to help avoid future financial crises. Since 2008, the G20 leaders have met at least annually, in part to monitor progress and refine and expand their financial reform agenda. The G20 leaders generally have called on their national authorities—along with the Financial Stability Board (FSB); international standard setting bodies, including the Basel Committee on Banking Supervision, International Organization of Securities Commissions (IOSCO, and International Association of Insurance Supervisors (IAIS)—to convert their broad financial reform agenda into more specific standards (including policies, principles, practices, or guidance). FSB, in collaboration with standard setting bodies, monitors the implementation status of the reforms and prepares periodic progress reports. Below is a summary of the implementation status of the G20 financial regulatory reforms based on the most recently available progress reports.

Implementation of Basel III Standards

At their 2010 summit in Seoul, the G20 leaders endorsed the Basel III capital standards and committed to adopt and implement them. As shown on table 1, all of the Basel Committee members reported that they have adopted or are in the process of adopting the Basel III capital requirements as of March 31, 2014 (the most recently available data). However, progress adopting the other Basel III requirements—the additional loss absorbency requirements for global and domestic systemically important financial institutions, liquidity coverage ratio, and leverage ratio—is less advanced and uneven.

**Table 1: Implementation Status of Basel III as of the end of March 2014**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Jurisdiction** | **Capital requirements** | **Requirements for global or domestic systemically important banks** | **Liquidity coverage ratio** | **Leverage ratio** |
| Argentina | Completed | In process | In process | No action |
| Australia | Completed | In process | Completed | No action |
| Brazil | Completed | No action | No action | No action |
| Canada | Completed | Completed | In process | No action |
| China | Completed | Completed | Completed | Completed |
| Hong Kong SAR | Completed | No action | In process | No action |
| India | Completed | In process | In process | In process |
| Indonesia | Completed | In process | No action | In process |
| Japan | In process | In process | No action | No action |
| Korea | Completed | In process | No action | No action |
| Mexico | Completed | No action | No action | No action |
| Russia | Completed | Completed | In process | In process |
| Saudi Arabia | Completed | In process | Completed | In process |
| Singapore | Completed | In process | No action | In process |
| South Africa | Completed | In process | In process | In process |
| Switzerland | Completed | Completed | In process | In process |
| Turkey | Completed | In process | Completed | Completed |
| United States | Completed | No action | In process | Completed |
| European Uniona | Completeda | In process | In process | In process |
| Belgium | In process | In process | No action | No action |
| France | Completed | In process | No action | No action |
| Germany | Completed | In process | No action | No action |
| Italy | Completed | In process | No action | No action |
| Luxembourg | Completed | In process | No action | No action |
| Netherlands | In process | In process | No action | No action |
| Spain | Completed | In process | No action | No action |
| Sweden | In process | In process | No action | No action |
| United Kingdom | In process | In process | No action | No action |

aThe European Union adopted the Capital Requirements Regulation and Directive IV to implement Basel III. The Capital Requirements Regulation includes Basel III’s capital, leverage, and liquidity requirements; is binding on all EU member states; and does not need to be transposed by EU member states into national law. The Capital Requirements Directive includes Basel III’s capital conservation and countercyclical buffers and has to be transposed by EU member states into national law.

Source: Basel Committee on Banking Supervision.

Notes: Notes: “No action” means draft regulation has not been published. “In process” means that a draft regulation or final rule has been published. “Completed” means that the final rule is in force.

Implementation of the Over-the-Counter (OTC) Derivatives Reforms

At the 2009 summit in Pittsburgh, the G20 leaders committed that all standardized OTC derivatives should be traded on organized trading platforms and centrally cleared; all OTC derivatives should be reported to a repository; and all noncentrally cleared OTC derivatives should be subject to higher capital requirements. At the 2011 summit in Cannes, the G20 leaders further agreed to require noncentrally cleared OTC derivatives to be subject to margin requirements—the posting of collateral to offset losses caused by the default of a counterparty.

As shown in table 2, almost all of FSB member jurisdictions reported that they have regulations in effect to implement the trade reporting and capital requirements as of March 31, 2014 (the most recently available data). In contrast, progress implementing the central clearing, exchange trading, and margin requirements is much less advanced and uneven across FSB member jurisdictions.

**Table 2: Status of Regulations Implementing OTC Derivatives Market Reforms as of April 2014**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Jurisdiction | Central Clearing | Exchange or electronic platform trading | Reporting to trade repositories | Capital | Margin |
| Argentina | Adopted | Adopted | Adopted | Effective | Consultation |
| Australia | Consultation | No action | Effective | Effective | N/A |
| Brazil | No action | No action | Effective | Effective | No action |
| Canada | Consultation | No action | Adopted | Effective | No action |
| China | Effective | Effective | Effective | Effective | No action |
| European Union | Consultation | No action | Effective | Effective | Consultation |
| Hong Kong SAR | No action | No action | Effective | Effective | No action |
| India | Adopted | Adopted | Effective | Effective | Effective |
| Indonesia | No action | Effective | Effective | No action | N/A |
| Japan | Effective | No action | Effective | Effective | No action |
| Korea | Adopted | No action | Effective | Effective | No action |
| Mexico | Proposed | Proposed | Effective | Adopted | No action |
| Russia | Consultation | No action | Effective | Effective | No action |
| Saudi Arabia | No action | No action | Effective | Effective | No action |
| Singapore | No action | No action | Effective | Effective | No action |
| South Africa | No action | No action | Consultation | Effective | No action |
| Switzerland | No action | No action | Effective | Effective | No action |
| Turkey | No action | No action | No action | No action | No action |
| United States | Effective | Effective | Effective | Adopted | Proposed |

Source: Financial Stability Board.

Notes: “No action” means no action has been taken to date. “N/A” means not applicable in a jurisdiction. “Consultation” means that official documents have been published for public consultation. “Proposed” means that draft regulations have been submitted through the appropriate process. “Adopted” means that final rules have been adopted in part or in full, and are enforceable. “Effective” means regulations are in force and operative for part or all of the market.

According to some FSB member authorities, resolution of cross-border issues continues to be the most significant implementation issue in light of the cross-border nature of OTC derivatives markets. Such issues include concerns about jurisdictional scope, duplication, and lack of consistency and coordination in requirements. Several authorities noted that current inconsistency across regulatory requirements may reduce the prospects for equivalence or comparability determinations, which could create duplicative or overlapping regulation or opportunities for regulatory arbitrage. According to FSB, in addition to unilateral and bilateral actions being undertaken to resolve some of the cross-border issues, a group of market regulators (the OTC Derivatives Regulators Group) has been meeting multilaterally to address a range of such issues. Other implementation issues include concerns about the usability of data reported to trade repositories. Some authorities are receiving and using the data, but inconsistencies in data fields and formats across trade repositories and in reporting approaches have been identified as one of the challenges for aggregating and analyzing data (including at the individual jurisdiction level). In April 2014, the FSB Chairman reported that at the upcoming G20 summit in November 2014, the OTC Derivatives Regulators Group will report on how it has resolved or intends to resolve the identified cross-border issues, and FSB will report on how information from trade repositories can be aggregated and shared among authorities.

Implementation of the G20 Reforms for Systemically Important Financial Institutions (SIFI)

At the Pittsburgh Summit in 2009, G20 leaders called on FSB to propose measures to address the systemic and moral hazard risks associated with SIFIs. The 2007-2009 financial crisis revealed weaknesses in the existing regulatory framework for overseeing SIFIs, which FSB defines as institutions of such size, market importance, and interconnectedness that their distress or disorderly failure could destabilize the financial system and result in severe economic consequences. In 2010, FSB developed a SIFI framework that is designed to reduce the probability and impact of SIFIs failing. At the Seoul Summit in 2010 the G20 leaders endorsed the framework, which includes requirements for (1) assessing the systemic importance of institutions, (2) additional loss absorbency for SIFIs, (3) more effective resolution mechanisms, and (4) stronger financial market infrastructure.

Designation of SIFIs

The first step in implementing the SIFI framework is identifying and designating global SIFIs. FSB and national authorities—in consultation with the Basel Committee, International Association of Insurance Supervisors (IAIS), and IOSCO—have developed and applied methodologies to designate global SIFIs.

* In November 2013, FSB published an updated annual list of global systemically important banks (G-SIB), which generally comprise the largest and most complex internationally active banks. The 29 G-SIBs are headquartered in 11 countries: 8 in the United States; 4 each in France and the United Kingdom; 3 in Japan; 2 each in China, Spain, and Switzerland; and 1 each in Germany, Italy, Netherlands, and Sweden. G-SIBs are grouped into one of five buckets based on their systemic importance, which correspond to increasing levels of additional loss absorbency requirements. The requirements are to be implemented by jurisdictions and phased in from January 2016, with full implementation by January 2019.
* In response to a request by the G20 leaders, FSB extended the SIFI framework to domestic systemically important banks (D-SIB). In October 2012, the Basel Committee issued its framework for dealing with such banks, which focuses on the impact that the distress or failure of banks will have on a domestic economy.
* In July 2013, FSB, in consultation with IAIS and national authorities, identified nine insurers as G-SIIs, which will be subject to a set of policy measures consistent with the SIFI framework. The nine G-SIIs are headquartered in six countries: 3 in the United States, 2 in the United Kingdom, and 1 each in China, France, Germany, and Italy.
* FSB, in consultation with IOSCO, developed draft methodologies to identify nonbank, noninsurance G-SIFIs, which were issued for public consultation in January 2014.

Resolution Regimes

At the Cannes Summit in 2011, the G20 leaders endorsed FSB’s Key Attributes of Effective Resolution Regimes for Financial Institutions (“Key Attributes”) as a new international standard for resolution. In April 2013, FSB reported that some of its member jurisdictions developed new or revised existing resolution regimes. For example, FSB noted that the United States has implemented a new resolution regime—referred to as Orderly Liquidation Authority (OLA)—aligned with FSB’s key attributes through its passage of the Dodd-Frank Act. OLA includes broad authorities to wind-up failing financial companies that meet certain systemic criteria. FSB also noted that Australia, Germany, Mexico, Netherlands, Spain, Switzerland, and the United Kingdom have amended their resolution regimes through legislative changes.

At the same time, FSB noted that many of its member jurisdictions need to take further legislative measures to implement the Key Attributes fully in substance and scope–in particular, the adoption of bail-in powers, powers for cross-border cooperation, and the recognition of foreign resolution actions. In September 2013, FSB reported that it will coordinate with IMF, the World Bank, and international standard setting bodies to finalize a methodology to assess implementation of the Key Attributes at the national level for use by IMF and the World Bank in their Standards and Codes Initiative.

Core Financial Market Infrastructures (FMI)

FMIs will have an increasingly important role in global and national financial markets going forward. In particular, reforms to require all standardized OTC derivatives to be centrally cleared reinforce the importance of strong safeguards and consistent oversight of the central clearing counterparties (CCP) for derivatives. Central clearing also is becoming increasingly common in the settlement of money market transactions, such as repos. The CPSS-IOSCO Principles for Financial Market Infrastructures (PFMIs), issued in April 2012, contain new and more demanding international standards for payment, clearing, and settlement systems.

In light of the move towards mandatory central clearing of OTC derivatives, all jurisdictions with systemically important CCPs must have in place powers to resolve them. FSB, in conjunction with standard-setting bodies, is developing guidance on how the Key Attributes should be interpreted and implemented with respect to the resolution of CCPs and other financial market infrastructures. In August 2013, CPSS/IOSCO published a consultative report on FMI recovery and FSB published its consultation on the resolution of FMIs.

Shadow Banking Reforms

At the 2011 Summit meeting in Cannes, the G20 leaders agreed to develop policies to deal with the fault lines exposed by the financial crisis in the part of the financial system that extends credit but is outside the regular banking sector, the so-called “shadow banking system.” Those fault lines centered on short-term wholesale funding, a variety of incentives problems in securitization, and a general lack of transparency that hid growing amounts of leverage and mismatch between long-term credit extension and short-term funding. In August 2013, FSB set out its approach to address financial stability concerns associated with shadow banking. It has focused on five specific areas:

* Mitigate the spillover effect between the banking and shadow banking systems, and the Basel Committee is developing proposals to address this issue;
* Reduce the susceptibility of money market funds to “runs,” and IOSCO is finalizing policy recommendations on this issue and plans to conduct a related peer review;
* Assess and align the incentives associated with securitization, and IOSCO is finalizing policy recommendations on this issue and plans to conduct a related peer review;
* Dampen financial stability risks and procyclical incentives associated with securities financing transactions, such as repos and securities lending, that may exacerbate funding strains in times of market stress, and FSB issued a policy framework on this issue; and
* Assess and mitigate systemic risks posed by other shadow banking entities and activities, and FSB has developed a high-level policy framework to detect and address sources of financial stability risks from shadow banking.

FSB, in coordination with the standard-setting bodies, will monitor the implementation of finalized policy recommendations and will report on the progress to the G20 in November 2014.

Implementation of Other Reforms

FSB has identified the aforementioned reforms as priority areas based on their importance to global financial stability. Those reforms undergo more intensive monitoring and detailed reporting by FSB or a standard setting body. In addition to the priority area reforms, there are a broad range of other G20 financial reforms. FSB monitors the implementation of these reforms but less intensively—primarily through annual surveys of its members. As shown on table 3, implementation of these reforms varies as of August 2013 (the most recently available data). All FSB members reported that they implemented or have been implementing 15 of the commitments, including strengthening oversight of shadow banking, registering hedge funds, and regulating credit rating agencies. In contrast, one or more FSB members reported taking no action to implement 11 nonpriority commitments, which include strengthening supervisory requirements for investment in structured products, strengthening national deposit insurance arrangements, and enhancing market transparency in commodity markets.

**Table 3: Implementation Status of the G20 Financial Reform Commitments in the Non-Priority Areas as Reported by the United States and Other FSB Member Jurisdictions, as of August 2013a**

| **G20 Financial Reform Areas and Objectives** | | **FSB Members:**  **Complete** | **Draft/ Ongoing** | **No Action** | **N/A** |
| --- | --- | --- | --- | --- | --- |
| Refining the regulatory perimeter | 1. Review of boundaries of the regulatory framework including strengthening oversight of shadow banking | 18 | 7 | 0 | 0 |
| Hedge funds | 2. Registration, appropriate disclosures and oversight of hedge fundsb | 17 | 5 | 0 | 2 |
|  | 3. Establishment of international information sharing framework | 15 | 3 | 2 | 5 |
|  | 4. Enhancing counterparty risk management | 19 | 6 | 0 | 0 |
| Securitization | 5.Improving the risk management of securitization | 20 | 4 | 1 | 0 |
|  | 6. Strengthening of regulatory and capital framework for monoline insurance firms | 3 | 5 | 0 | 17 |
|  | 7. Strengthening of supervisory requirements or best practices for investment in structured products | 16 | 7 | 2 | 0 |
|  | 8. Enhanced disclosure of securitized products | 16 | 7 | 2 | 0 |
| Enhancing supervision | 9. Consistent, consolidated supervision and regulation of SIFIs | 18 | 7 | 0 | 0 |
|  | 10. Establishing supervisory colleges and conducting risk assessments | 16 | 3 | 0 | 6 |
|  | 11. Supervisory exchange of information and coordination | 20 | 4 | 0 | 1 |
|  | 12. Strengthening resources and effective supervision | 22 | 3 | 0 | 0 |
| Building and implementing macro-Prudential frameworks and tools | 13. Establishing regulatory framework for macro-prudential oversight | 22 | 3 | 0 | 0 |
|  | 14. Enhancing system-wide monitoring and the use of macro-prudential instruments | 18 | 6 | 1 | 0 |
|  | 15. Improved cooperation between supervisors and central banks | 22 | 2 | 1 | 0 |
| Improving oversight of credit rating agencies | 16. Enhancing regulation and supervision of CRAs | 23 | 2 | 0 | 0 |
|  | 17. Reducing the reliance on ratingsc |  |  |  |  |
| Enhancing and aligning accounting standards | 18. Consistent application of high-quality accounting standards | 23 | 2 | 0 | 0 |
|  | 19. Appropriate application of Fair Value Accounting | 19 | 6 | 0 | 0 |
| Enhancing risk management | 20. Enhancing guidance to strengthen banks' risk management practices, including on liquidity and foreign currency funding risks | 19 | 6 | 0 | 0 |
|  | 21. Efforts to deal with impaired assets and raise additional capital | 17 | 5 | 1 | 2 |
|  | 22. Enhanced risk disclosures by financial institutions | 23 | 2 | 0 | 0 |
| Strengthening deposit insurance | 23. Strengthening of national deposit insurance arrangements | 10 | 10 | 2 | 3 |
| Safeguarding the integrity and efficiency of financial markets | 24. Enhancing market integrity and efficiency | 12 | 9 | 1 | 3 |
|  | 25. Enhanced market transparency in commodity markets | 10 | 9 | 3 | 3 |
|  | 26. Legal Entity Identifier | 11 | 12 | 1 | 1 |
| Enhancing financial consumer protection | 27. Enhancing financial consumer protection | 15 | 10 | 0 | 0 |

Source: FSB.  
  
aThe data are self-reported by FSB member jurisdictions, and FSB generally does not evaluate the survey responses to verify the accuracy or assess the effectiveness of implementation.

bUnited Kingdom did not submit a response.  
  
cFSB did not collect information for its members on this G20 commitment, because it was conducting a thematic peer review on this issue.

Importantly, the survey data are self-reported by FSB member jurisdictions. According to an FSB official, the FSB Secretariat has followed up bilaterally in a small number of cases to collect additional information and clarify certain responses, but FSB generally does not evaluate the survey responses to verify the accuracy or assess the effectiveness of implementation. As a result, the survey findings do not allow straightforward comparisons between jurisdictions or across reform areas.

**Appendix II: Reviews Conducted by the International Monetary Fund (IMF), Financial Stability Board (FSB), and Basel Committee to Assess Reform Implementation and Effectiveness**

IMF, FSB, and the Basel Committee have programs to monitor the implementation of international financial standards and review the effectiveness of the supervision. These programs include IMF and the World Bank’s Financial Sector Assessment Program (FSAP) assessments, FSB’s thematic and country peer reviews, and the Basel Committee’s jurisdictional and thematic reviews.

* FSAP provides the framework for comprehensive and in-depth assessments of a country’s financial sector. In 2010, IMF made financial stability assessments under FSAP mandatory for members with systemically important financial sectors. As of November 2013, IMF has identified 29 jurisdictions as having such a sector.[[5]](#footnote-5) Since 2013, IMF has conducted FSAPs on, among others, Austria, Brazil, Belgium, Canada, France, Hong Kong SAR, Italy, India, Korea, Poland, Singapore, and Switzerland. (These FSAPs are available at <http://www.imf.org/external/np/fsap/fssa.aspx>.)
* FSB’s country peer reviews focus on the implementation of international standards and their effectiveness nationally. The reviews examine steps taken or planned by national authorities to address FSAP and ROSC recommendations. (FSB peer reviews take place 2 to 3 years following an FSAP.) FSB has completed peer reviews of Australia, Canada, Germany, Indonesia, Italy, Mexico, South Africa, Spain, Switzerland, the United Kingdom, and the United States. (These peer review reports are available at <http://www.financialstabilityboard.org/list/fsb_publications/tid_141/index.htm>.)
* FSB’s thematic peer reviews focus on the implementation and effectiveness of FSB-endorsed international standards deemed important for global financial stability. The objectives of the reviews are to encourage consistent cross-country and cross-sector implementation, evaluate (where possible) the extent to which standards have had their intended results, and identify gaps and weaknesses in reviewed areas. FSB has completed thematic reviews on reducing reliance on CRA ratings, resolution regimes, risk governance, deposit insurance systems, compensation, and risk disclosure practices, mortgage underwriting and origination practices.
* In 2012, the Basel Committee created its Regulatory Consistency Assessment Program (RCAP) to monitor progress in introducing regulations, assess their consistency (jurisdictional assessments), and analyze regulatory outcomes (thematic assessments). The committee has completed six jurisdictional assessments—Australia, Brazil, China, Japan, Singapore and Switzerland—in which it found each jurisdiction’s regulations to be “compliant” overall with the Basel minimum standards. The committee is currently assessing Canada, the European Union, and the United States. In addition, the committee has completed three thematic assessments on the risk-weighting of assets by banks. The assessments found considerable variation in risk weighted assets across banks, in part attributed to differences in supervisory practices.

1. Subgroup 1 members include China, Cyprus, the European Court of Auditors, Hungary, Mexico, Netherlands, Poland, Russian Federation, Saudi Arabia, Spain, Sweden, United Kingdom, United States, and Venezuela. [↑](#footnote-ref-1)
2. Subgroup 2 members include Canada, Republic of Korea, and the United States. [↑](#footnote-ref-2)
3. Subgroup 3 members include Austria, Brazil, Chile, Finland, France, Indonesia, Morocco, and United States. [↑](#footnote-ref-3)
4. Other government research entities, such as the U.S. Office of Financial Research (OFR), and academic researchers have been conducting research on measures of systemic risk and ways to identify trends in the financial system. For example, in 2012 OFR published a report surveying 31 quantitative measures of systemic risk in the economics and finance literature, with the goal of providing researchers with resources to further analyze risks. See Bisias, Dimitrios, Mark Flood, Andrew Lo, Stavros Valavanis, “A Survey of Systemic Risk Analytics,” *Office of Financial Research Working Paper #0001 (*Jan. 5, 2012)*.*  [↑](#footnote-ref-4)
5. The jurisdictions are Australia, Austria, Belgium, Brazil, Canada, China, Denmark, Finland, France, Germany, Hong Kong SAR, Italy, India, Ireland, Japan, Luxembourg, Mexico, the Netherlands, Norway, Poland, Russia, Singapore, South Korea, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. [↑](#footnote-ref-5)