

To G20 Finance Ministers and Central Bank Governors

The financial stability outlook remains challenging. Inflation persists above target in many jurisdictions. Despite easing recently, global financial conditions are significantly tighter than a year ago and may undergo further tightening in the months to come. Economic growth has slowed markedly in recent months. Whilst expectations of a 'soft landing' for the global economy have grown, the outlook remains clouded by uncertainty. Emerging market and developing economies (EMDEs) have been largely resilient thus far, but this backdrop may present challenges to them as we move forward.

Despite being buffeted by several severe shocks in recent years, the core of the financial system has largely coped with these real-world stress tests, with limited and temporary support where necessary. The post-global financial crisis reform agenda coordinated by the FSB, working with the sectoral standard-setting bodies, has gone a long way in bolstering the resilience of the global financial system. But there is further work to be done.

Economic history reminds us that the combination of near-record high levels of public and private sector debt, rising debt service costs and stretched asset valuations in some key markets can pose serious threats to financial stability. As we confront this environment in 2023, monitoring and addressing remaining conjunctural vulnerabilities, as well as a number of structural vulnerabilities, will require particular vigilance.

The remainder of this letter briefly discusses how the FSB aims to do this.

Non-bank financial intermediation (NBFi)

Events over the last year have continued to emphasize the importance of addressing vulnerabilities in the non-bank sector. Early last year, after Russia's invasion of Ukraine, some commodities firms faced challenges in sourcing cash collateral to cover the spike in margin requirements, and this led to some market volatility. This follows previous episodes of liquidity demand in the non-bank sector amplifying market shocks and spilling over to broader financial markets, underscoring the importance of the FSB and its members taking steps to materially enhance the resilience of the sector.

We are delivering for this meeting a report on the financial stability aspects of commodity markets, which identified a number of vulnerabilities. In contrast to the structure in many other financial markets, a small number of non-financial trading firms play an outsized role. These non-financial firms are connected with core financial market participants through their activities across a range of physical and derivatives markets. Commodities traders can be highly leveraged and rely on banks for short-term funding. Importantly, many of the vulnerabilities

and channels of contagion identified in the report, including leverage, the impact of large margin calls, and opacity, are not unique to commodities markets and are being addressed in the FSB's work programme to enhance the resilience of NBFI.

Another important piece of the NBFI work programme is the in-depth study of forms of leverage that are not always apparent in supervisory and regulatory data. For example, derivatives can be used to take leveraged positions that are not easy to see in typical balance sheet measures of leverage, or leverage can be built up in portions of the financial system that are less regulated, such as occurred in the Archegos family office incident.

Some types of open-ended funds have experienced periods of stress, a case in point being the March 2020 market turmoil. We are continuing our policy work to address liquidity mismatch in open-ended funds and promote greater and more consistent use of funds' liquidity management tools. This includes enhancing our 2017 FSB recommendations (informed by lessons learned from the March 2020 episode). Additional work in this area includes running a pilot programme to improve data on open-ended funds for financial stability monitoring and coordinating with IOSCO on the development of detailed guidance on liquidity management tools.

We will undertake work to enhance market participants' liquidity preparedness for margin and collateral calls, which were important factors in the March 2020 market turmoil, and to identify data gaps in regulatory reporting.

Finally, in conjunction with IOSCO, we will conduct a peer review of money market mutual fund policy reform measures, to take stock of members' progress in implementation of reforms designed to make this sector more resilient.

Crypto-assets and decentralised finance

The events of the past year, such as the collapse of FTX, have highlighted the intrinsic volatility and structural vulnerabilities of crypto-assets. We have now seen first-hand that the failure of a key intermediary in the crypto-asset ecosystem can quickly transmit risks to other parts of that ecosystem. And, if linkages to traditional finance grow, risks from crypto-asset markets could spill over onto the broader financial system. The G20 has charged the FSB with coordinating the delivery of an effective and comprehensive regulatory framework for crypto-assets, for which we and the sectoral standard setters have jointly put forth an ambitious 2023 work programme.

This year, the FSB will finalise its recommendations for the regulation, supervision and oversight of crypto-assets and markets and its recommendations targeted at global stablecoin arrangements, which have characteristics that may make threats to financial stability more acute. The recommendations for global stablecoin arrangements include guidance to strengthen governance frameworks, clarify and strengthen the redemption rights and the need to maintain effective stabilisation mechanisms, among other revisions. Importantly, the FSB's work concludes that many existing stablecoins would not currently meet these high-level recommendations, nor would they meet the international standards and supplementary, more detailed BIS Committee on Payments and Market Infrastructures-International Organization of Securities Commissions guidance.

Collectively, these recommendations seek to promote the comprehensiveness and international consistency of regulatory and supervisory approaches, recognizing that many crypto-asset activities and markets are currently not compliant with applicable regulations or are unregulated. We are working with our members, including the sectoral standard-setting bodies, to complete this critical work. Additionally, we will deliver a joint paper with the IMF later this year that synthesises the policy findings from IMF work on macroeconomic and monetary issues and FSB work on supervisory and regulatory issues associated with crypto-assets. We will also explore how to address the cross-border risks specific to EMDEs. Publication of the FSB's recommendations will only be the beginning of the next phase of work in this area, as the standard-setting bodies will need to make their own, more detailed, recommendations, and member jurisdictions will need to implement the recommendations. The FSB will continue to coordinate that work, as necessary, and going forward will monitor implementation of the recommendations together with the standard-setters. Once the work is completed, the appropriate regulation of crypto-assets, based on the principle of 'same activity, same risk, same regulation' will provide the beginning of a strong basis for harnessing potential benefits associated with this form of financial innovation while containing its risks.

Within the crypto-asset ecosystem, so-called decentralised finance (DeFi) has emerged as a fast-growing segment, and we are delivering to this meeting a report on DeFi. Our report points to the need for proactive monitoring, filling data gaps, and exploring to what extent the crypto-asset recommendations may need to be enhanced to cover DeFi risks. We will build on this work to examine whether additional policy recommendations are needed to deal with this growing segment.

The FSB continues to conduct forward-looking analysis to assess the implications of crypto-assets for financial stability. This year we are undertaking in-depth analysis of the large crypto-asset intermediaries that provide a wide range of services to the ecosystem. We will also undertake analysis of the increasing trend toward the tokenisation of assets and how that could affect financial stability.

Enhancing cross-border payments

One factor that has helped spur the development of the crypto-asset ecosystem is dissatisfaction with the existing system of cross-border payments. In 2020, G20 Leaders endorsed the Roadmap for Enhancing Cross-border Payments, in order to address the frictions that such payments currently face and thereby achieve faster, cheaper, more transparent and more inclusive cross-border payment services.

Last year we reported to the G20 that this work had reached the next phase, focused on implementation. For this meeting, the FSB is delivering a report with detailed next steps under the new phase of the Roadmap, comprising high-priority, practical steps to achieve the Roadmap's goals. This is being accompanied by the setting up of two new taskforces to work in partnership with the private sector as we take the work forward. Continued G20 support remains vital here.

Cyber and operational resilience

Cyber incidents continue to be a part of our financial landscape. They have grown in frequency and sophistication and will likely continue to do so as the financial system becomes increasingly digitalised. The growing interconnectedness of the financial system also increases the likelihood of a cyber incident at one financial institution, or an incident at one of its third-party service providers, having spill-over effects across borders and sectors. All of this underlines the importance of continuing to work on strong cyber risk safeguards.

In April, we will deliver a revised report to the G20 on achieving greater convergence in cyber incident reporting that incorporates public feedback. Information on cyber incidents is crucial for effective incident response and recovery and for promoting financial stability. The consultative document takes a comprehensive approach and includes recommendations to address impediments to convergence, advances work on establishing common terminologies related to cyber incidents and proposes the development of a common format for incident reporting exchange. We will also deliver a consultative document to the G20 aimed at strengthening financial institutions' ability to manage third-party and outsourcing risk. This will include expectations for financial authorities' oversight of financial institutions' reliance on critical service providers, including Big-Tech and FinTech firms.

Climate change

Climate change remains a key priority for financial regulators and supervisors, given its considerable implications for global financial stability. The FSB continues to coordinate work to address climate-related financial risks through its climate roadmap. A pivotal goal in this regard is the finalisation of the International Sustainability Standards Board (ISSB) global standards for climate disclosures, in the first half of this year. The development of climate-related corporate disclosures will provide a unique opportunity to avoid harmful fragmentation and create a global baseline standard at the outset that enables users to compare and aggregate exposures across jurisdictions. Interoperability between the common global baseline and national and regional jurisdiction-specific requirements continues to be crucial to avoid unnecessary costs. We will update you later this year on further progress in climate disclosures and reporting, in coordination with ISSB, IOSCO and others.

Crucial in the fight against climate change will be gaining a better understanding of how climate change can affect financial stability, and we will continue to enhance our analysis and monitoring of climate related vulnerabilities. This includes work we are undertaking, in coordination with the Network for Greening the Financial System, on how the information in transition plans can be used for managing transition-related risks to financial stability.

Conclusion

Financial stability is indispensable to robust and sustainable economic growth. Our ambitious workplan for 2023 highlights the various areas in which progress will be made to further strengthen the global financial system, from climate risks to cross-border payments, crypto-assets to investment funds.

The deeply interconnected and globalised nature of the financial system is such that a multilateral, cross-sectoral policy approach is required to enhance its resilience, along with an approach focused on coordination and policy consistency. Working through its members, the FSB is uniquely placed to conduct this coordination and will continue to do so steadfastly in 2023.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'Klaas Knot', with a stylized, cursive script.

Klaas Knot

Annex: FSB reports to the G20 during the 2023 Indian Presidency

Date	Report
February	Financial stability aspects of commodities markets Financial stability implications of decentralised finance (DeFi) Updated set of prioritised actions under Cross-border Payments Roadmap
April	Achieving convergence in cyber incident reporting – finalised report and format for incident reporting exchange (FIRE) report
July	Regulatory and supervisory approaches to crypto-assets and markets - finalised recommendations Regulatory and supervisory approaches to global stablecoin arrangements - finalised recommendations Third-party risks and outsourcing – consultation paper Annual progress report on FSB Roadmap for Addressing Financial Risks from Climate Change Revised FSB Recommendations to address liquidity mismatch in open-ended funds – consultation paper
September	FSB-IMF synthesis note on macroeconomic and regulatory perspectives on crypto-assets Financial stability implications of leverage in the non-bank sector Enhancing the resilience of NBFIs: progress report
October	Promoting Global Financial Stability: 2023 FSB Annual Report Annual progress report on climate-related disclosures Annual progress report on Cross-border Payments Roadmap