PIIE PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS

POLICY BRIEF

17-12 Race to the Top: The Case for the Financial Stability Board

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April 2017

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Before the global financial crisis, huge imbalances had built up in the US financial sector, which went largely undetected by the existing regulatory apparatus. In the aftermath of the crisis, there was broad agreement that financial regulation in the United States needed to be more rigorous.

In 2010 Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act, which strengthened the regulatory architecture. Banks are now required to hold more capital and liquidity, steps have been taken to make derivatives markets safer and more transparent, and protocols have been adopted to diminish the risk of "too big to fail." The pendulum has swung in the direction of stronger standards and a sharper focus on preserving financial stability.

Some key features of the global financial system make international regulatory coordination essential to reduce vulnerabilities to the US economy, foster a reliable flow of credit to US households and firms, and provide a level global playing field for the US financial sector. The Financial Stability Board (FSB) has proved an effective vehicle for coordinating outcomes that are favorable for the global economy and, more important from a domestic perspective, the United States.

The United States has played a leadership role in the FSB since the group's inception, and important benefits have flowed to the US economy as a result. US participants have sought agreement on global regulatory standards that are broadly compatible with those in the United States. The FSB has provided a framework to encourage other jurisdictions—including some that might have otherwise been reluctant to do so—to toughen their regulatory regimes in line with steps taken in the United States.

This spirited defense of the FSB does not suggest that the FSB has a perfect track record. It needs to be improved in light of experience and evolving circumstances. This Policy Brief suggests several areas where the governance, transparency, and work program of the FSB could be strengthened. It draws on FSB documents and the related literature, as well as my experience as one of three US members of the FSB from September 2014 to January 2017, when I served as US Treasury undersecretary for international affairs.

ORIGINS OF THE FSB

In response to the financial crisis, there was agreement in the United States that financial regulation needed to be more thorough and vigorous. Measures were needed to strengthen major financial institutions—by, for example, raising capital and liquidity requirements and more thoroughly assessing the business strategies and risk management practices of these institutions.

There was also a desire to make the new system as internationally consistent as possible. This desire reflected several factors. The crisis highlighted that imbalances from weakly regulated jurisdictions could quickly propagate around the world, given massive global financial flows and resulting linkages across countries. Similarly, weak regulation in some jurisdictions creates incentives for regulatory arbitrage, which can incentivize excessive risk taking and the buildup of vulnerabilities in those jurisdictions and on the balance sheets of internationally active institutions (see Posen 2015).

Consistent with these observations, in the early stages of this effort, Treasury Secretary Timothy Geithner noted, "We can't do this alone. If we continue to allow risk and leverage to migrate where standards are weakest, the entire US-global financial system will be less stable in the future."[1] The aim was for the postcrisis architecture to be characterized by a race to the top rather than a descent to weak standards.

In addition, in the absence of cooperation, US institutions would likely face a patchwork of international regulatory approaches, which would fragment the global financial system, as investors and institutions faced different regulatory demands and expectations in different jurisdictions. The flow of capital and investment across borders would be constrained, which ultimately could limit the ability of the financial system to provide credit to households and firms. This patchwork of regulation would also reduce the scope for US institutions to compete successfully in foreign markets, particularly if regulation in some jurisdictions was less rigorous than in the United States.

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In response to these considerations, at their first formal summit, in December 2008, President George W. Bush and the other G-20 leaders concluded:

> We will implement reforms that will strengthen financial markets and regulatory regimes so as to avoid future crises.... However, our financial markets are global in scope, therefore, intensified international cooperation among regulators and strengthening of international standards, where necessary, and their consistent implementation is necessary to protect against adverse cross-border, regional and global developments affecting international stability. (G-20 Communiqué)

The leaders also called on regulators "as a matter of priority" to strengthen their "cooperation on crisis prevention, management, and resolution."

The upshot of this injunction was the creation of the Financial Stability Board at the next leaders' summit, in April 2009, which President Barack Obama attended.[2] At that time, the leaders underscored:

> We each agree to ensure that our domestic regulatory systems are strong. But we also agree to establish the much greater consistency and systematic cooperation between countries, and the framework of internationally agreed high standards, that a global financial system requires. (G-20 Communiqué)

In line with these instructions, the FSB was given a strong multifold mandate to foster financial stability at the international level. It was assigned to monitor and assess vulnerabilities in the global financial system and to oversee the actions needed to remedy them; encourage coordination and exchange of information on regulatory policies and promote best practices in this sphere; and work with the standard-setting bodies (such as the Basel Committee and the International Organization of Securities Commissions [IOSCO]) to ensure that their efforts were timely, relevant, and well-coordinated.

Members of the FSB, in turn, agreed to pursue policies to foster financial stability and promote "openness and transparency" of the financial sector. They also committed to implement internationally agreed standards and codes and to be subject to peer reviews.

The remarkable similarities between the leaders' statements in December 2008 and April 2009, notwithstanding the transition from the Bush administration to the Obama administration, highlight the bipartisan determination at the time to strengthen regulation and the shared view across the two administrations that doing so required international cooperation.

STRUCTURE OF THE FSB

The FSB brings together officials with broad perspectives on the global financial system, including participants from finance ministries, central banks, and market regulators. This expertise covers every part of the financial system and provides deep understanding of various jurisdictions and the functioning of international financial markets and institutions.

In its current structure—which has changed little since its creation during the financial crisis—the 70 members of the FSB "plenary" come from 25 different jurisdictions, including both advanced and emerging-market economies. Also represented are the major standard-setting bodies (e.g., the Basel Committee, IOSCO, and the International Association of Insurance Supervisors [IAIS]), as well as the international financial institutions (e.g., the IMF and World Bank) (see FSB 2016c). The FSB is headquartered in

1. Timothy Geithner, "Press Briefing," September 2009, www.g20.utoronto.ca/2009/2009geithner0924.html.

2. The G-20 leaders transformed the Financial Stability Forum (FSF), which had existed since 1999, into the Financial Stability Board. The FSF, which previously reported to the G-7, was made accountable to the G-20 leaders. In addition, its membership was expanded to include key emerging-market economies, and its financial stability mandate was broadened. For details, see Lombardi (2011).

Basel, Switzerland; its secretariat is hosted by the Bank for International Settlements.

Underneath the plenary group, which has ultimate decision-making and governance responsibilities for the FSB, are three standing committees, focused on regulatory cooperation, the assessment of global financial vulnerabilities, and the vetting of members' compliance with agreed upon standards. Of the three, the committee on regulatory cooperation, which develops and examines all proposals for international regulatory reform, is the most powerful.

The FSB's steering committee is made up of a subset of plenary members. It provides operational guidance to the chair and helps prepare for plenary meetings.

Mark Carney, the governor of the Bank of England (and former governor of the Bank of Canada), has been the chair of the FSB since 2011. The participants for the United States include a Federal Reserve governor, the Treasury undersecretary for international affairs, and the chair of the Securities and Exchange Commission. Most recently, these positions were held by Dan Tarullo (who also chaired the powerful committee on regulatory cooperation), me, and Mary Jo White. In addition, senior officials from other US agencies, including the Commodity Futures Trading Commission (CFTC) and the Federal Deposit Insurance Corporation (FDIC), are brought into FSB discussions on issues related to their responsibilities. Through this mechanism, the FSB draws deeply on expertise in the United States and in other jurisdictions as well.

The FSB will see a significant change in its senior leadership this year. Its charter limits the chair to two three-year terms. Mark Carney's second term ends in November 2017. Dan Tarullo's tenure as chair of the committee on regulatory cooperation expired this spring. The term of Ravi Menon (of the Monetary Authority of Singapore), who has chaired the standards implementation committee, has also expired. The FSB announced in late February that, effective April 1, Norman Chan (of the Hong Kong Monetary Authority) would succeed Tarullo and Lesetja Kganyago (of the South African Reserve Bank) would replace Menon. Both of the new appointees are highly regarded internationally and have strong records of economic leadership.

ACCOMPLISHMENTS OF THE FSB

In recent years the FSB has defined its work around four high-level objectives: (1) strengthening the capital and liquidity on bank balance sheets, (2) reforming over-the-counter (OTC) derivatives markets, (3) addressing "too big to fail," and (4) reducing vulnerabilities in shadow banking (also referred to as "market-based finance"). Meaningful progress has been made in each of these areas, but, to varying degrees, additional work remains to be done.

Accomplishments in increasing the capital in the banking system have been significant. Tier 1 capital ratios—ratios of banks' core equity capital to their total risk-weighted assets—in the advanced economies rose significantly over the past decade (figure 1). Since agreement on the Basel III framework, in 2010, the tier 1 capital held by the 30 institutions the FSB has identified as global systemically important banks (G-SIBs) has risen to $3 trillion, and tier 1 capital ratios have correspondingly risen (figure 2).[3] Tier 1 capital holdings have markedly increased in both US and foreign G-SIBs in recent years (figure 3). Banks have also increased the liquidity on their balance sheets, essentially closing shortfalls in the liquidity coverage ratio (figure 4). In August 2016 the FSB reported that all large internationally active banks meet capital and leverage requirements and 80 percent meet minimum liquidity standards (FSB 2016a). This progress in strengthening the balance sheets of large institutions is the core achievement of the postcrisis effort to make the global financial system less prone to crisis and better able to support growth.

Responding to one of the key lessons of the financial crisis, the FSB has also worked to make financial markets, particularly OTC derivatives markets, safer and more transparent. There has been a significant increase in the value of derivatives contracts that are centrally cleared (figure 5), and most derivatives transactions are now reported to trade repositories (figure 6).

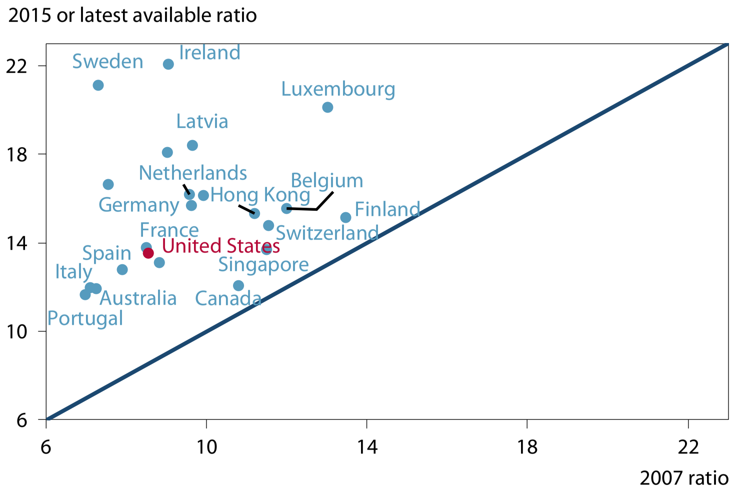
The achievements in this area are important, but reaping the full benefit of these reforms requires that jurisdictions move together in implementation and carefully coordinate their efforts. Uneven implementation across jurisdictions or ineffective coordination among regulators has at times created uncertainties for investors and led to fragmentation in global financial markets. The United States has been a pacesetter in adopting these reforms. All jurisdictions need to press toward full implementation (see FSB 2016b).

The volume of complex securitized products has fallen significantly in recent years (figure 7). The decline apparently reflects both heightened awareness of risk on the part of market participants and the stricter regulatory environment.

Progress has also been achieved toward ending "too big to fail," both by increasing the buffers large institutions hold on their balance sheets and by strengthening the frameworks used in resolution. The 30 G-SIBs are now subject to higher capital requirements than they were before the crisis. In addition, beginning in January 2019, they will be required

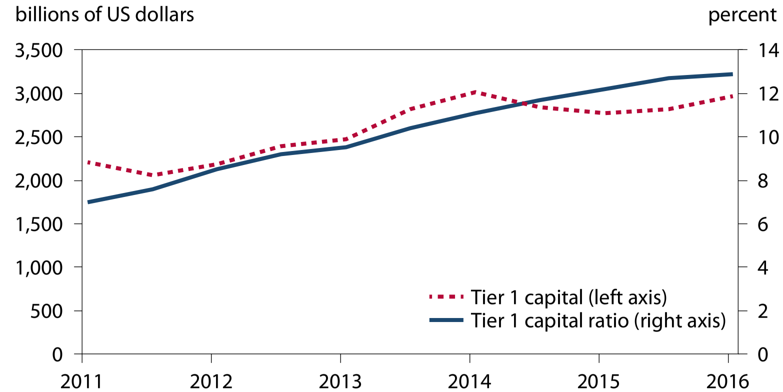
3. Of the 30 G-SIBs, 15 are European (including 8 from the euro area), 8 are American, 4 are Chinese, and 3 are Japanese ("2016 List of Global Systemically Important Banks (G-SIBs)," November 21, 2016, www.fsb.org/wp-content/uploads/2016-list-of-global-systemically-important-banks-G-SIBs.pdf).

Figure 1 Tier 1 capital ratios in advanced economies (percent)



Source: IMF *Global Financial Stability Report*, October 2016.

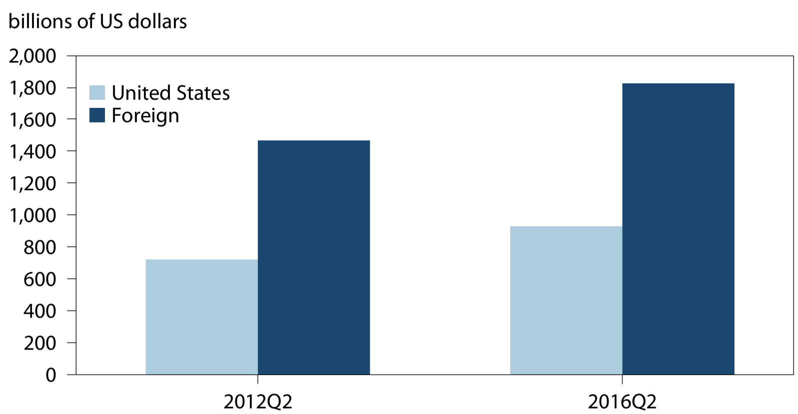
Figure 2 Tier 1 capital in global systemically important banks (G-SIBs), 2011–16



Note: Tier 1 capital levels assume full phasing in of Basel III; data are for the 30 G-SIBs identified by the FSB.

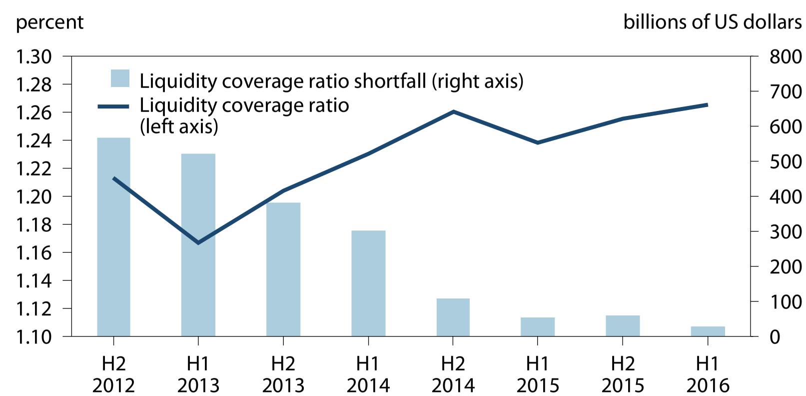
Source: BCBS (2017); source data are reported in euros.

Figure 3 Tier 1 capital in US and foreign G-SIBs, 2012Q2 versus 2016Q2



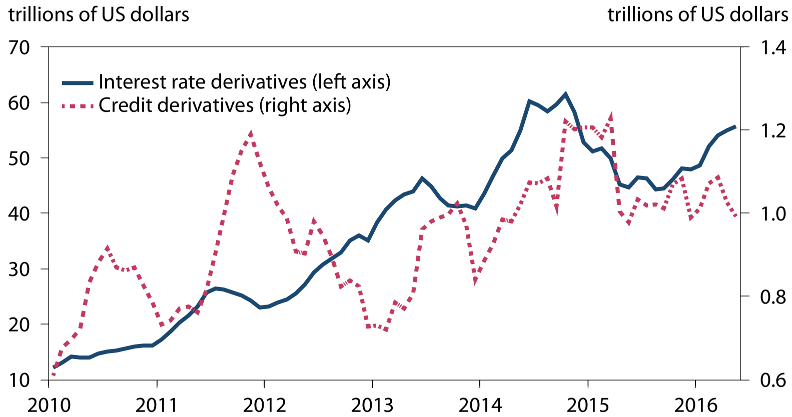
Source: FDIC Global Capital Index, www.fdic.gov/about/learn/board/hoenig/capital.html.

Figure 4 Declining liquidity shortfalls in global banks, 2012H2 to 2016H1



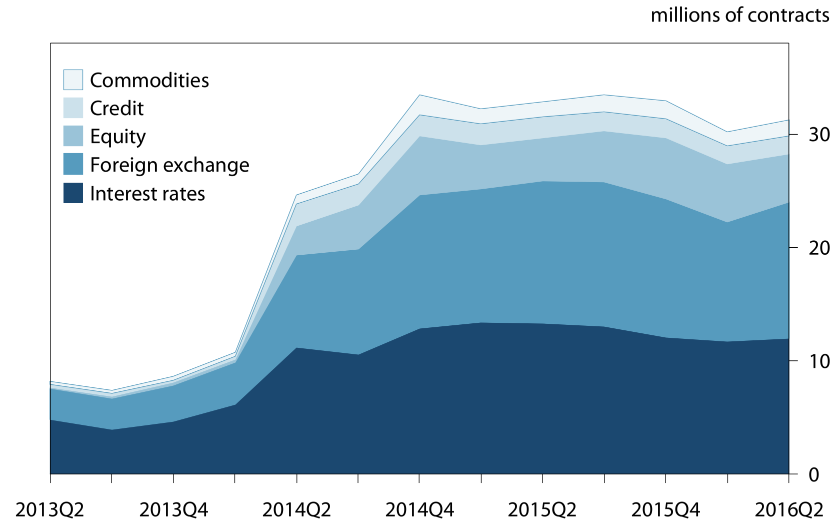
Sources: BCBS (2017). Source data are for 82 internationally active banks; reported in euros.

Figure 5 Central clearing of over-the-counter derivatives, 2010–16



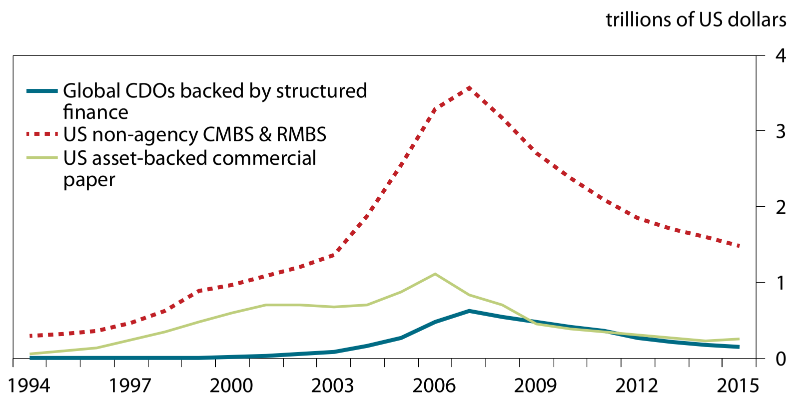
Source: FSB (2016a, 2016b).

Figure 6 Over-the-counter derivatives trades reported to repositories, 2013–16



Sources: FSB (2016a) and national trade repositories.

Figure 7 Volume of complex securitization products, 1994–2015



CDO = collateralized debt obligations; CMBS = commercial mortgage-backed securities; RMBS = residential mortgage-backed securities

Sources: FSB (2016a), Federal Reserve, Securities Industry and Financial Markets Association (SIFMA).

to meet a total loss-absorbing capacity (TLAC) standard, to ensure that they have additional buffers to protect taxpayers in the event of resolution.[4] These institutions are also subject to resolution planning requirements, including resolvability assessments, as well as to enhanced supervisory standards for their risk-management and other operations. The FSB's most recent assessment is that implementation of the G-SIB capital and TLAC standards and efforts to strengthen regulation are proceeding smoothly. However, the challenge of making resolution regimes more effective and more compatible across jurisdictions remains incomplete.

The FSB has also identified nine global systemically important insurers (G-SIIs), with the expectation that they will be subject to internationally agreed upon standards.[5] In consultation with the IAIS, the FSB continues work developing a methodology to assess the potential risks from large insurers and the prudential requirements that these institutions should satisfy. The effort has seen a divergence of views within the international community regarding the best approaches to assess and mitigate risks in the insurance sector. The FSB and IAIS need to gain further traction on both assessing the underlying analytical issues and building international consensus.

Coming out of the financial crisis, it was clear that potential risks in the shadow banking sector needed to be better understood. Given the heterogeneity of this sector, the first step has been to document and monitor various shadow banking activities and to think through some broad principles for addressing potential vulnerabilities. Structures have also been developed for member jurisdictions to share information, and broad principles regarding oversight and regulation have been agreed upon. Progress has been most concrete in the area of strengthening the resilience of money market mutual funds.

As a related effort, in January 2017 the FSB articulated a set of 14 recommendations designed to address structural vulnerabilities in the asset management sector (FSB 2017). Although this work has generated controversy in recent years, especially in the United States, stakeholders seem to view the ultimate recommendations—which focus on liquidity mismatch, leverage, operational risk, and securities lending activities—as broadly constructive.

The FSB continues to face a demanding work agenda. In a letter to G-20 leaders in August 2016, Mark Carney reported that "our collective priorities must be to implement our past agreements in a full, timely, and consistent manner; to address new risks and vulnerabilities; and to continue to build an open global financial system that benefits all."[6] Consistent with this objective, the FSB is likely to press forward on efforts to complete the final chapter of Basel III (sometimes called Basel IV); encourage full implementation of OTC derivatives commitments; and consider ways to further strengthen resolution regimes, including for central counterparties. Work will continue on potential systemic risks in insurance, asset management, and shadow banking, as well as potential new risks to the system, such as from fintech (computer programs and other technology used to support or enable banking and financial services). In sum, the FSB is working mainly on implementing existing initiatives rather than urgently framing new policies. Quite appropriately, there is increased emphasis on evaluating the effects of past and ongoing reforms.

DEBATE OVER THE FSB

Despite its accomplishments, the FSB has been the subject of vigorous debate and questioning in the United States. A recent exchange of letters between Federal Reserve Chair Janet Yellen and Congressman Patrick McHenry (R-NC) highlights many of the issues in play:

> It appears that the Federal Reserve continues negotiating international regulatory standards for financial institutions among global bureaucrats in foreign lands without transparency, accountability, or the authority to do so. . . . It is incumbent upon all regulators to support the US economy, and scrutinize international agreements that are killing American jobs. (Letter from Rep. Patrick McHenry to Janet Yellen, January 31, 2017)

> By participating in the development of international regulatory standards, the Federal Reserve can influence the standards in ways that promote the financial stability of the United States and the competitiveness of US firms. In some important

4. The objective of TLAC is to ensure that these large banks have buffers over and above their required capital holdings that, in the event of resolution, are available to be bailed in. Instruments that may be counted as TLAC include common equity and subordinated or senior unsecured debt with a maturity of more than one year. The features of this TLAC requirement are outlined in "Principles on Loss-Absorbing and Recapitalisation Capacity of G-SIBs in Resolution: Total Loss-Absorbing Capacity (TLAC) Term Sheet," November 9, 2015, www.fsb.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf.

5. This list includes three US institutions, five European institutions, and one Chinese institution. See "2016 List of Global Systemically Important Insurers (G-SIIs)," November 21, 2016, www.fsb.org/wp-content/uploads/2016-list-of-global-systemically-important-insurers-G-SIIs.pdf.

6. FSB Chair's letter to G-20 Leaders—Building a Resilient and Open Global Financial System to Support Sustainable Cross-Border Investment, August 31, 2016, www.fsb.org/2016/08/fsb-chairs-letter-to-g20-leaders-building-a-resilient-and-open-global-financial-system-to-support-sustainable-cross-border-investment.

> instances, US agencies have used international forums to promote standards already determined domestically to be important for US financial stability. Beyond the benefits to our economy from strong standards in the United States, the financial stability of the United States is also enhanced when foreign banks are subject to strong standards that cover their global consolidated operations. (Letter from Janet Yellen to Rep. Patrick McHenry, February 10, 2017)

At least some of the criticism of the FSB seems to represent a back-door effort to discredit the toughened US financial regulatory regime by associating it with "global bureaucrats in foreign lands." But the United States did not arrive at its current regulatory configuration because the FSB forced US authorities to get there. The toughened US regime is in place because stretching back to the first G-20 leaders' meeting in December 2008, Congress and US policymakers have believed that rigorous standards are necessary.

The United States is in the midst of a political debate about whether the regulatory reform effort has been calibrated appropriately and what the direction and nature of the next steps on regulation should look like. A debate of this kind is healthy. Whatever the outcome—and whatever the trajectory of future US regulatory policy—the FSB can serve as a valuable venue for US policymakers to explain their thinking, describe the stance of their policies, and seek collaboration with foreign counterparts.

With these comments in hand, the rest of this section considers four criticisms that have been voiced regarding the functioning and effectiveness of the FSB:

- The FSB is poorly governed and unaccountable to appropriate political oversight.
- The United States is obligated to implement FSB decisions, essentially granting sovereignty to an international body.
- The FSB is not sufficiently transparent in its operations and decisions.
- FSB policy decisions do not adequately incorporate American interests.[7]

7. The readout of a February 23, 2017, meeting between Treasury Secretary Steven Mnuchin and FSB Chair Carney (www.treasury.gov/press-center/press-releases/Pages/sm0013.aspx) stated this point in an affirmative way: "Secretary Mnuchin noted that one of the administration's core principles for financial regulation is to promote American interests in international financial regulatory negotiations and meetings." To date there has been no elaboration of how this objective will be translated into actual policies.

Governance and Accountability of the FSB

The FSB is governed by—and accountable to—the G-20 leaders, who established it in April 2009. The FSB continues to report regularly to and receive assignments from the leaders.[8] In addition, the chair of the FSB reports several times a year to the G-20 ministers and governors, and the work program of the FSB is actively discussed at these meetings, as manifest in a long series of communiqués.

Within the FSB, decisions are made by consensus in the plenary. The chair has the power to propose policies, but negotiations must continue until an approach is identified that has the support of the entire membership.[9] Extended periods of deliberation have sometimes been necessary to reach agreement. This means that the United States, like other member countries, has an effective veto on FSB decisions.

A governance issue that various commentators have noted relates to the geographical mix of the FSB membership. Of the 70 officials who are members of the FSB, 60 represent national or regional institutions (including the European Central Bank and the European Commission), with the remaining 10 coming from the standard-setting bodies and international financial institutions. Of the national representatives, 21, including the chair, are from Western Europe.[10]

The upshot is that the European voice in these discussions is strong. Although this is a feature of many international groups (reflecting both historical factors and the fact that Europe is divided into many countries), it has fueled a perception in the United States that Europe has the upper hand in FSB negotiations.[11]

In practice, several factors offset this imbalance. First, given the size of the US financial system and the breadth of

8. The chair of the FSB attends the annual G-20 leaders' meeting and presents a summary of the FSB's work program.

9. Articles 9 and 21 of the FSB's June 2012 charter specifically address these issues.

10. See, for example, Veron (2016), who looks at the FSB and other international regulatory bodies. He finds evidence of European overrepresentation in these bodies but argues that a "North Atlantic bias" in their membership, leadership, and the location of their headquarters is even more pronounced. (The recent appointments of Norman Chan and Lesetja Kganyago to FSB leadership positions should help address both concerns.) A High-Level Panel on FSB Governance (Brooking Institution 2011) recommended locating chairs who "come from regions other than Europe." (When first appointed, Mark Carney was governor of the Bank of Canada; he moved to the Bank of England in 2013.)

11. See, for example, the September 2015 letter from Senator Richard Shelby (R-AL) to Treasury Secretary Jack Lew, Fed Chair Yellen, and SEC Chair Mary Jo White, www.banking.senate.gov/public/index.cfm/republican-press-releases?ID=3E578BB0-5056-A063-C0E0-7E55D2BAD9F1.

US national interests, US participants bring extensive expertise to the table, and this fact is recognized internationally. As a result, the views of US participants carry a correspondingly significant weight in FSB deliberations. Second, the FSB includes other US voices (particularly the CFTC and the FDIC) on issues relevant to their mandates, and Mark Carney has skillfully managed the body, with a clear recognition of the central role of the US financial system. Third, the United States played a key role in the founding of the FSB. Secretary Geithner hailed the establishment of the FSB as marking a "fourth pillar" of the international financial architecture along with the IMF, the World Bank, and the World Trade Organization.[12] In the years since, US officials have continued to be vigorously engaged in driving the FSB's work. Finally, as noted above, the FSB is a consensus-based organization, so US members can block measures they oppose.

At least some of the criticism of the FSB seems to represent a back-door effort to discredit the toughened US financial regulatory regime by associating it with "global bureaucrats in foreign lands."

Even so, a necessary governance reform should carefully examine the extent of Western European representation, especially of some national central banks that, with the advent of the Single Supervisory Mechanism, have much diminished regulatory responsibilities. It should determine whether the mix of the membership across geographies and areas of expertise remains appropriate.

US Commitments as an FSB Member

The discussion of FSB governance and accountability raises two important issues. First, what responsibility do FSB members have to implement agreements reached by the group? Second, what is the relationship between the process of policy formulation in the FSB and in national regulatory frameworks?

A March 2015 exchange between Representative Jeb Hensarling (R-TX), chair of the House Financial Services Committee, and Treasury Secretary Jack Lew highlights the first of these questions (see Wallison 2015). Hensarling asked why the FSB had found it necessary to explicitly exempt Chinese banks from the proposed TLAC standard, if countries were not bound to implement the agreement.[13]

The answer is that the FSB is a collaborative body, and countries thus have no formal requirement to implement the agreed policies. Article 23 of the FSB charter underscores this point: "This Charter is not intended to create any legal rights or obligations" (FSB 2012). There is no formal mechanism to require or adjudicate compliance (unlike, say, the WTO's dispute arbitration facilities). FSB processes recognize the reality that agreements must be implemented with due regard for national institutions, legal structures, and other country-specific situations. In addition, countries are free to implement standards that exceed those articulated by the FSB (known as "super equivalence").

As a practical matter, several factors taken together mean that national authorities have strong incentives to implement the policies agreed to in the FSB. First, by its very construction, the FSB includes key regulators and prudential authorities from major jurisdictions. These participants are inclined to agree to policies at the international level only if they see them likely to be beneficial in their home jurisdictions. Second, one of the core goals of the FSB is to find common ground on regulatory policies—with an eye toward reaping the benefits of a level playing field across jurisdictions. If a country expects other jurisdictions to implement strong regulatory policies, it has incentives to implement such policies, in order to be in harmony with others and reap the benefits of a level global playing field. Third, the FSB regularly performs peer reviews to assess how well its members are abiding by the agreements made within the context of the FSB. In this respect, there is accountability. Fourth, given that FSB negotiations are a repeated process, a country's credibility and influence within the group is in part determined by its willingness to implement the policies agreed. Failure to implement today may translate into reduced influence in international negotiations tomorrow. Indeed, by moving quickly and forcefully to implement agreements, as the United States often has, countries can shape the features of implementation in other jurisdictions. Together these factors represent powerful reasons for FSB members to implement agreements, but they are not a legal or formal requirement to do so.

The flipside of this discussion is also important. US authorities have used the cooperative framework provided by the FSB to the United States' benefit, seeking to achieve

12. Geithner, "Press Briefing," September 2009.

13. The final FSB agreement on TLAC included a provision applying the TLAC standard to Chinese and any other emerging-market G-SIBs but with a lag relative to the advanced economies. This lag reflects the more preliminary development of their corporate bond markets, the market in which TLAC will be issued.

a level global playing field based on the high-quality standards that have been implemented in the United States. As one example, by identifying global systemically important financial institutions (G-SIFIs), the FSB is attempting to ensure that large institutions around the world are identified and treated similarly. In response, regulators abroad have taken actions to increase required capital levels and remedy other vulnerabilities associated with these institutions, as the United States has done under Dodd-Frank. This is consistent with the observation in Chair Yellen's letter referenced above that "in some important instances, US agencies have used international forums to promote standards already determined domestically to be important for US financial stability." The result has been a better-regulated and safer global financial system.

In the United States, the debate has been particularly contentious on the issue of how to best mitigate the risks that arise in the nonbank financial sector. These arguments have had two major prongs. First, the FSB has been criticized for inappropriately extrapolating its methodologies for banks to other parts of the financial sector, including insurance and asset management. On the one hand, the experience of the financial crisis underscores that regulators must recognize risks outside the banking sector. On the other hand, developing appropriate regulatory approaches for parts of the financial system that have not been subject to the same regulatory scrutiny as banks is (unsurprisingly) proving to be time consuming, resource intensive, and analytically challenging. The original efforts on this front focused on assessing risks associated with large institutions. More recent work is complementing those efforts by examining systemic vulnerabilities that may arise through the activities undertaken in the sector.

A second issue of contention has been the relationship between the FSB and the Financial Stability Oversight Council (FSOC) processes for naming G-SIFIs. The FSB review is entirely distinct from the deliberative process the FSOC undergoes in designating firms as systemically important in the United States, as required by the Dodd-Frank Act. US regulators are bound by US law in setting regulations; nothing regarding the FSB changes that fact. The FSOC acts consistent with its best judgment. An FSOC outcome that differed substantively from that of the FSB could be costly in terms of credibility in future FSB negotiations, but it is legally possible. Indeed, given the differing memberships of the two groups (the FSOC includes a broader swath of US regulatory agencies) as well as their own timetables and deliberative processes, the possibility of differing outcomes cannot be entirely dismissed.

Given these concerns, it would be helpful for the FSB to reaffirm how it views the responsibilities of its members and the relationship between the FSB process and the determinations of national regulatory authorities. The issue bears deeply on key parts of the group's charter and on the core nature of the FSB as a body that is cooperative but places expectations on its members.

The second question above probes the practical relationship between policy formulation in the FSB and in national frameworks. Two core realities frame this discussion. On the one hand, it is impossible for any country—even one as large and influential in international discussions as the United States—to simply impose its domestic solutions on the rest of the world. On the other hand, any representative of the United States in international negotiations must first and foremost seek outcomes that are acceptable to key domestic stakeholders. These sometimes competing realities determine the envelope of possible outcomes for international negotiations.

The work of the FSB over the past several years highlights that it is often possible to find a solution within this trade space. The FSB has played a critical role in facilitating such outcomes. Even so, at times efforts fall short. For example, through the end of 2016 and into January 2017, regulatory officials sought an international agreement to complete the last chapter of Basel III to achieve increased consistency of capital requirements across jurisdictions. To date such an agreement has not been achieved, with views of what constitutes an acceptable solution varying markedly across the two sides of the Atlantic (the United States has advocated a more vigorous approach than what key European jurisdictions have been willing to accept).

Transparency of the FSB

Another issue that has drawn significant attention is whether the FSB is sufficiently transparent in its operations (see, for example, McIntosh 2013). The FSB's charter requires it to consult widely with stakeholders, explicitly including stakeholders in the private sector, and to "have a structured process for public consultation on policy proposals."

According to the FSB's annual report, its website is the principal mechanism for its public outreach and communication. Between April 2015 and March 2016, the website had 1.1 million unique views. Materials available on the website include information on the membership, organization, and history of the FSB, along with a range of press releases, speeches, and analytical documents describing the work the FSB is doing.

The FSB's public communications take a number of forms. The group provides press releases following each of its plenary meetings. It issues separate press statements on important plenary decisions and posts detailed analytical papers supporting such decisions on the website. In recent years it has published an annual report summarizing its work programs and initiatives for the G-20 leaders, as well as letters to the G-20 throughout the year. The FSB also prepares a report each year assessing the implementation and effects of the prescribed reforms. It is working to strengthen the analytics underlying this report (as discussed below).

The FSB also regularly seeks public consultations on its work products and preliminary proposals. Between mid-December 2016 and late February 2017, for example, it sought public consultations on four important work products: (1) approaches to central counterparty resolution and resolution planning, (2) principles for internal TLAC, (3) continuity of access to financial market utilities for a firm in resolution, and (4) recommendations from a task force on climate-related financial disclosures.

The FSB also holds outreach meetings with experts and stakeholders to seek input on evolving work products. Its chair, other members of the FSB, and members of the FSB Secretariat give public speeches and make other public remarks throughout the year, which provide the public with another window into the deliberations and trajectory of its policies.

The FSB thus provides a broad range of reports and explanations to the public—about policy proposals that are in gestation and about the rationales for the decisions it has taken. However, concerns continue to swirl around this issue, as highlighted by the reference to transparency in the McHenry letter. Given that much of the FSB leadership is turning over this year, 2017 would be a natural time for the FSB to examine its transparency practices and assess whether they are sufficient.

One concrete proposal for consideration is making the data the FSB uses to evaluate the effectiveness of its reform initiatives available in a regularly updated public database. Information on aggregate capital, liquidity, and various measures of performance and risks for the global financial system as a whole is inadequate. The FSB is a natural supplier of these data, especially because it has identified many relevant series in the course of preparing its various reports.

Benefits to the United States of FSB Participation

The FSB has benefited the United States by clearly articulating international best practices and then encouraging FSB members to implement those higher standards. The result has been a more transparent and coherent global financial system.

In addition, the United States has used the FSB to motivate the rest of the world to adopt stronger standards than it would otherwise have adopted. It is impossible to fully document the ebb and flow of past negotiations, but in the years since the financial crisis, the United States has generally been on the "tough side" of international regulatory debates—seeking to make standards more rigorous. This stance is reflected by the fact that a number of features of the US regulatory regime are super equivalent (i.e., exceed the minimums articulated by the FSB). To protect taxpayers and insure against future crises, US policymakers have put in place somewhat tougher standards than those agreed to internationally. The Volcker Rule, for example, has no exact international counterpart, and other core requirements, such as the supplementary leverage ratio and TLAC, go beyond international standards. The United States has also led in implementing reforms of OTC derivatives and has advocated for a relatively vigorous approach to finalizing Basel III.

The position that past international agreements have "unfairly penalized the American financial system" or that "some FSB actions may unfairly benefit European entities"—as Rep. McHenry and Senator Shelby claim in their letters cited earlier—is thus not accurate. Rather, the work of the FSB has raised standards in the rest of the world, albeit in some instances not as high as those that US regulators have adopted to foster financial stability and protect US taxpayers.

Supporters of the work of the FSB need to do a better job of presenting the case for international cooperation and showcasing the accomplishments of the FSB in achieving its goals. The work of the FSB is technical and its policy papers abstruse; more energy needs to be exerted in explaining the benefits for workers and firms. Similarly, the FSB over the years could have done a more effective job of documenting the bottom-line benefits of its policies. As mentioned above, the FSB is now developing a stronger framework to evaluate the effectiveness of the reforms that have been implemented. This is important and constructive, but difficult analytically.

BENEFITS OF US LEADERSHIP

The balance of the evidence indicates that the FSB has helped the world achieve stronger regulatory standards—a "race to the top." As a result, the global economy—and hence the US economy, given linkages across countries—is more resilient and better able to support strong, sustainable, and balanced growth.

Through US influence, intensive efforts have been made to ensure that the regulatory approaches endorsed by the FSB are broadly consonant with those pursued in the United States. Indeed, in some key instances, the United States has employed the FSB to motivate the rest of the world to implement the same tough regulatory policies it adopted to ensure the safety and soundness of its own system. As a result, the risk of foreign financial turmoil is lower, and the US economy is better protected from such spillovers.

The FSB, however, does not have a perfect track record; there is still scope for the group to review the representation of its membership (across both geographic areas and areas of expertise), reflect on its transparency practices, expand its data offerings to the public, and more convincingly document the benefits of the reforms that have been put in place. In addition, the FSB's work program should remain focused on its core mandate of global financial stability; pressures to stray into other areas should continue to be resisted.

The significant turnover in FSB leadership over the next year provides an opportunity for a thorough stocktaking, from people inside and outside the FSB. The reforms that are needed are incremental, however. The FSB has served its constituents well.

The extent and nature of US participation in the FSB is just one example of a class of decisions that the Trump administration will face as it defines the role of the United States within the global economic architecture (see Truman 2017). Previous administrations, both Republican and Democrat, have subscribed to the view that active US participation and leadership in these groups is in the United States' interest, because the global interlinkages in some areas, such as financial regulation, make cooperation imperative. For other challenges, such as combatting terrorist financing, collaborative global action also provides a clear and desirable moral force. US leadership allows the United States to better gear global resources and international policy initiatives in directions that will be beneficial domestically.

The world looks to the United States for leadership. This is true not only because of the size of the US economy and the preeminent role of US financial markets but also because of the quality of ideas, the breadth and intensity of engagement, and the sustained commitment to an economic system that is open, transparent, and resilient. If the United States fails to deliver on these fronts, its capacity to lead will be damaged, and other countries will step in to fill the vacuum. The result could very well be rules and practices in the global economy and financial system that evolve in directions that are inconsistent with US national interests.

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