

U.S. International Economic Leadership: The Case for the FSB

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U.S. International Economic Leadership: The Foundations



- Largest national economy
- Pre-eminent financial markets
- Legacy of U.S. leadership and engagement
 - Quota/shares in the IFIs
 - Reserve currency and global safe assets
- Quality of ideas and intensity of engagement – we speak on every issue!
- Passed the test during the last crisis...
 - Dollar was the safe-haven currency & Fed acted as global lender of last resort



U.S. International Economic Leadership: Domestic Benefits

- We lead with an eye toward global growth and protecting the global commons
- Seek outcomes that are fair for all, transparent, and rules-based – “race to the top”
- But importantly, we lead with an eye on U.S. policies and interests
- Seek to gear resources and initiatives in ways that are beneficial to us
- Encourage others to implement the high-quality policies we adopt at home
 - Levels the playing field for our workers and firms

U.S. International Economic Leadership



- If we don't lead, other countries will – and *in ways consistent with their own interests*
- For example, one recent news story:

“China Defends WTO in Face of Trump Rebuke”: *The world’s second largest economy is seeking to position itself as a defender of the international trade system... “China would like to work with all WTO members to ensure that the WTO can play an important role in global trade...” foreign ministry spokesman Geng Shuang told reporters. He added, the “open and unbiased multilateral trade regime is conducive to improving world economic development.”* (AFP, March 2, 2017)

Agenda for Remainder of the Talk



- One specific example of international cooperation – financial regulation
 - The Financial Stability Board (FSB) has been the key mechanism for this cooperation
- The domestic debate regarding the FSB
- What has the FSB accomplished?
- Some reforms to further enhance the FSB's effectiveness



Two Objectives for Financial Regulation Following the Crisis

- Establish more thorough, vigorous regulation
 - Strengthen financial institutions' balance sheets (capital and liquidity)
 - More thoroughly scrutinize business strategies & practices
- Ensure as much international consistency as possible. *Why?*
 - Avoid regulatory arbitrage – building up of risk in less regulated jurisdictions. Given sizeable linkages, risks abroad flow onto our shores!
 - Avoid fragmented global markets – limiting the flow of credit
 - Provide a level playing field for U.S. institutions to compete abroad

Favorable outcomes for the U.S. economy require responsible policies in other countries!

- Broad international agreement on both of these points

Two Models for Coordinating Regulation Internationally



- *National Model*: The U.S. sets its standards, and then seeks to have those standards adopted abroad
 - *Risk*: Differing frameworks result in patchwork regulation for the globe
 - The U.S. is “first among equals,” but it cannot dictate!
- *International Model*: U.S. officials reach agreements abroad and then seek to implement them here
 - *Risk*: Politically challenging – e.g., Woodrow Wilson’s League of Nations
- In practice, framing financial regulations requires ongoing triangulation across constituencies
 - The FSB greatly facilitates this effort



Structure of the FSB

- Established by the G-20 Leaders in April 2009
- “Plenary” includes officials from finance ministries, central banks, and regulatory agencies
 - Participants from 25 jurisdictions (both advanced and emerging)
 - U.S. Members: Treasury, the Fed, and the SEC
 - The CFTC, FDIC, and other U.S. agencies are regularly drawn in as well
- Also includes IFIs and “standard-setting bodies” (Basel Committee, Securities, Insurance, etc.)
- Expertise in all corners of the financial system
- “Plenary” and “Steering Committee” chaired by Mark Carney
- Three standing committees: Supervision and regulatory cooperation (Tarullo); Assessing vulnerabilities (Knot); Standards implementation (Menon)



Domestic Criticisms of the FSB

- Poorly governed and unaccountable to political oversight
- Compromises U.S. sovereignty
 - Forces undesirable decisions and policies on U.S. regulators
- Secretive and non-transparent in its functions and decisions
- Policies don't reflect U.S. interests and hurt our economy
 - One example – McHenry letter to Yellen:

“...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 U.S. economy, and scrutinize international agreements that are killing American jobs.”



FSB Governance and Functioning

- The FSB reports several times a year to G-20 Ministers & Governors and annually to Leaders
 - G-20 communiqués – a long series of tasks to the FSB
 - *Reporting lines and accountability are clear!*
- Decisions are taken by consensus – the FSB cannot dictate policies to national authorities
 - Decisions aren't *formally* binding – the FSB Charter underscores that it does not “create any legal rights or obligations.”
 - National officials translate agreements into domestic standards – with necessary regard for unique circumstances
- The FSB's levers are moral suasion and peer reviews
 - But members have *incentives* to implement agreed policies

FSB Governance and Functioning (continued)



- Through the FSB, the U.S. has sought the same high standards abroad as adopted here
- One example: The FSB has identified systemically important institutions, and members have required higher standards for them
 - Similar to the regime Congress mandated under Dodd-Frank
 - Of course, only FSOC can make *formal* designations under U.S. law (see above)
- As a result, the global system is safer – and regulation abroad is more similar to ours
- Yellen response to McHenry:
“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... In some important instances, U.S. agencies have used international forums to promote standards already determined domestically to be important for U.S. financial stability.”



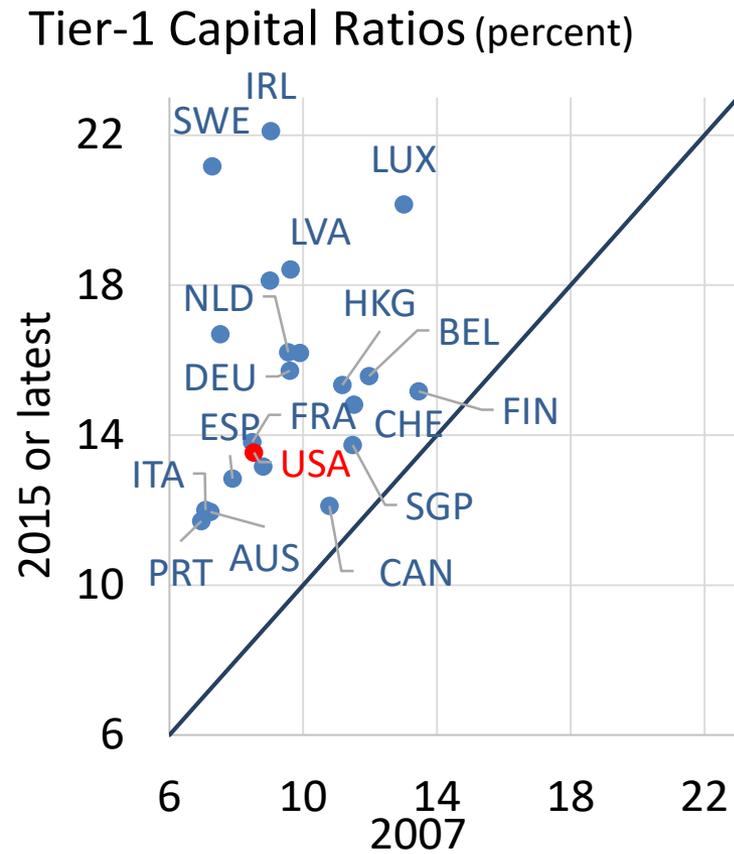
FSB Transparency

- The FSB Charter requires it to have a “structured process for public consultation” and to consult widely with stakeholders
- Its website is the principal platform for public communication
- This communication includes
 - Press releases describing Plenary meetings and decisions
 - Annual reports on FSB activities and periodic letters to G-20
 - An annual report assessing implementation and effects of reforms
 - Requests for public comment on policies being considered
 - Speeches by the FSB Chair, members, and secretariat
- Given pending FSB leadership changes, this year is a natural time to review transparency practices

FSB Accomplishments Since the Crisis

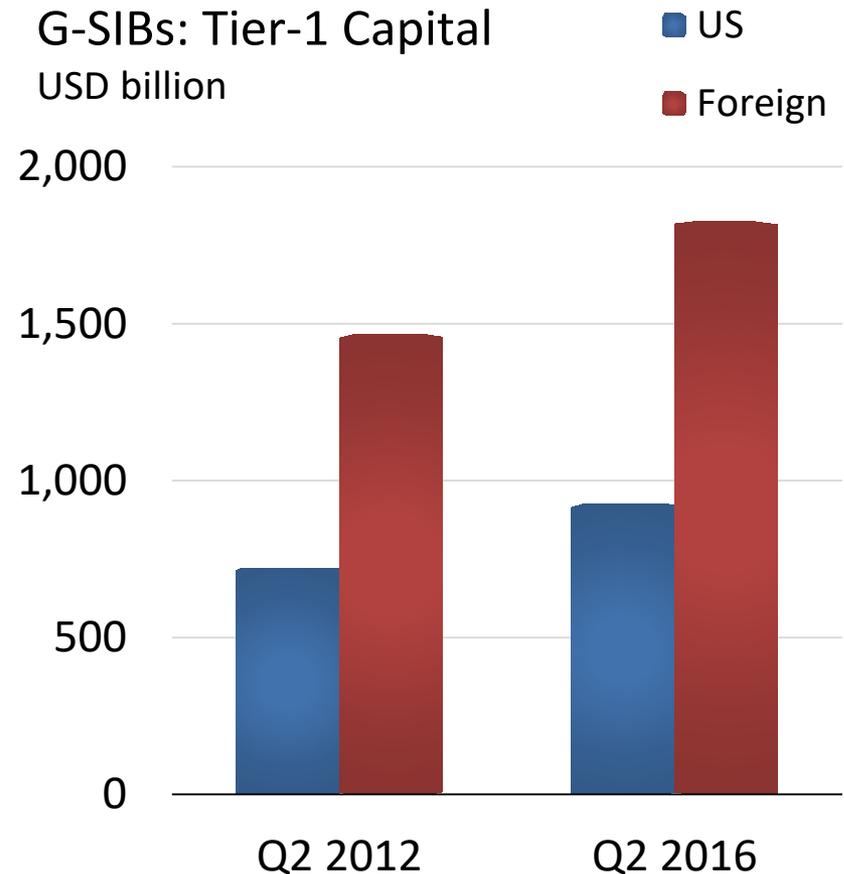
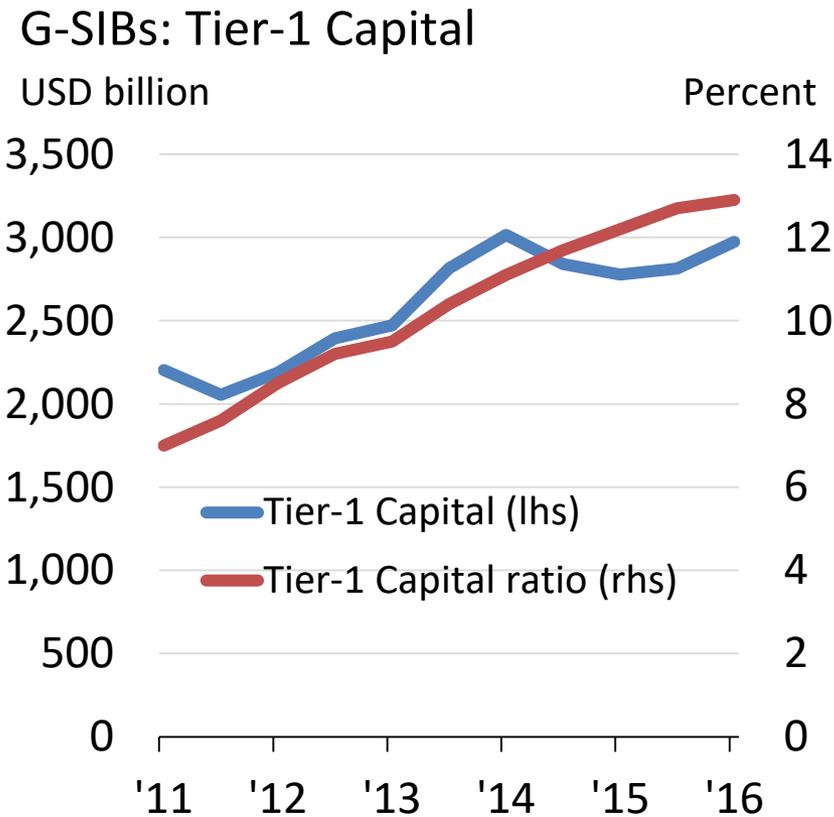


- The ultimate question must be – “Is the global financial system safer?”
- Bank balance sheets have been bolstered significantly
 - Much enhanced quantity and quality of capital
 - Additional liquidity buffers in place



Source: IMF GFSR Oct 2016

Bank Capital Levels are Substantially Higher



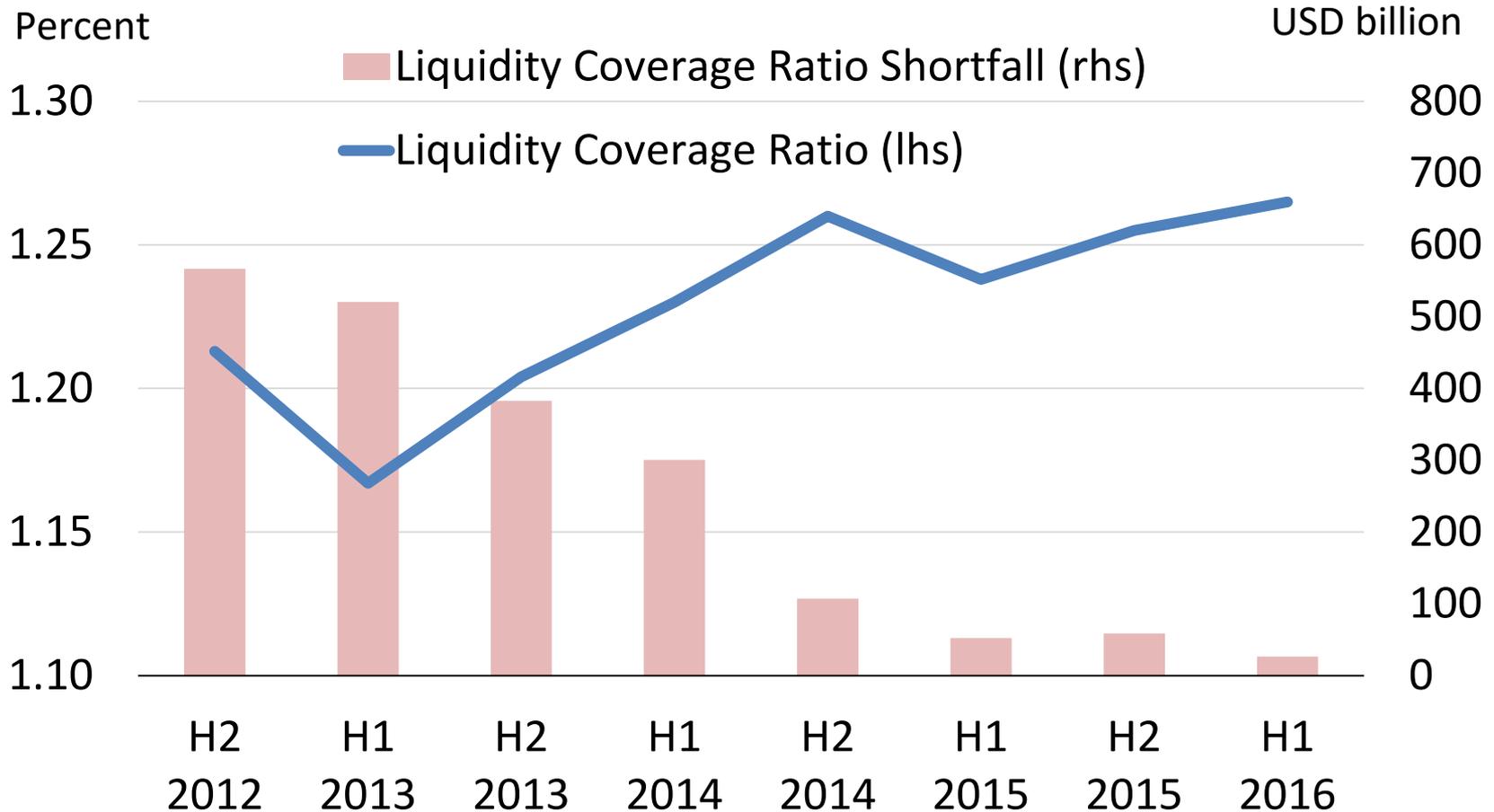
Note: Tier-1 capital levels assume full phasing in of Basel III; data are for the 30 G-SIBs identified by the FSB.

Source: BCBS; source data reported in Euros.

Source: FDIC Global Capital Index.



Liquidity Shortfalls Have Declined

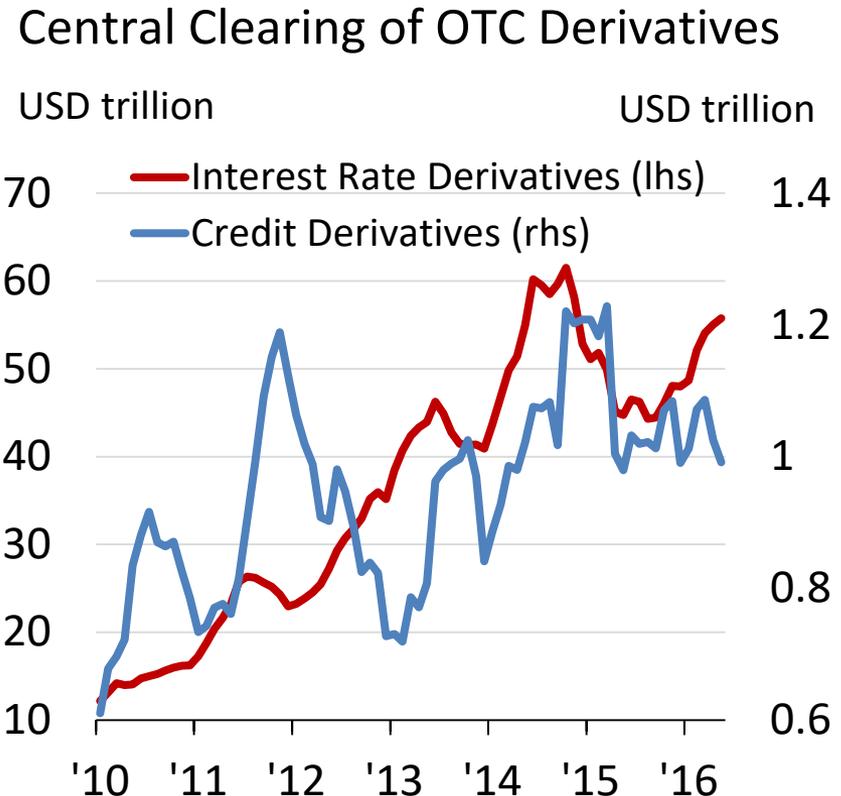


Source: FSB, BCBS; source data are reported in Euros.



Derivatives Markets Are Safer

- During the financial crisis, opaque OTC derivatives markets and inter-linkages posed key risks
- The FSB has sought to enhance trading, clearing, and reporting
 - Pushed trading to standard contracts on exchanges where possible
 - Increased use of central clearing
 - Trades reported to data repositories



Source: FSB; Source data reported in euros.



Other Accomplishments of FSB

- Resolution frameworks – progress toward ending “Too Big to Fail”
 - Systemically important institutions required to meet tougher standards – higher capital and closer supervision
 - Agreement on Total Loss Absorbing Capacity (TLAC)
 - Adoption of standards for effective resolution regimes
- Market-Based Finance
 - Review of potential systemic risks associated with non-banks activities, e.g., asset managers
 - Improved information sharing and assessment of vulnerabilities (including efforts to compile global data)
- De-risking: Ensuring access to correspondent banking services

Efforts coordinated by the FSB have made the financial system safer!



The FSB's Current Work Program

- Mark Carney to G-20 Leaders, August 2016:
“Our collective priorities must be to implement our past agreements in a full, timely, and constant manner; to address new risks and vulnerabilities; and to continue to build an open global financial system that benefits all.”
- Continue developing standards for globally important insurance companies; push forward examining potential systemic risks for asset management
- Press members to fully implement agreements on OTC derivatives reforms
- Further consider resilience, recovery, and resolvability of central counterparties
- Basel III finalization?
- Strengthen tools to evaluate the effects of existing reforms

How Can the FSB Increase Its Effectiveness?



- The pending turnover in FSB leadership provides an opportunity to consider ways to enhance FSB's effectiveness
 - This question should be a focus for G-20 and FSB itself
 - *The FSB's record is strong – but reflection is still useful*
- *Representation*: Is the mix of members right – across geographies, areas of expertise, etc.?
- *Transparency*: Are there refinements that would be helpful to the FSB in achieving its mandate?
- *Public Communication*: Can the FSB make its case more persuasively?
- *Focus*: Are work streams fully linked to the core mandate of global financial stability?