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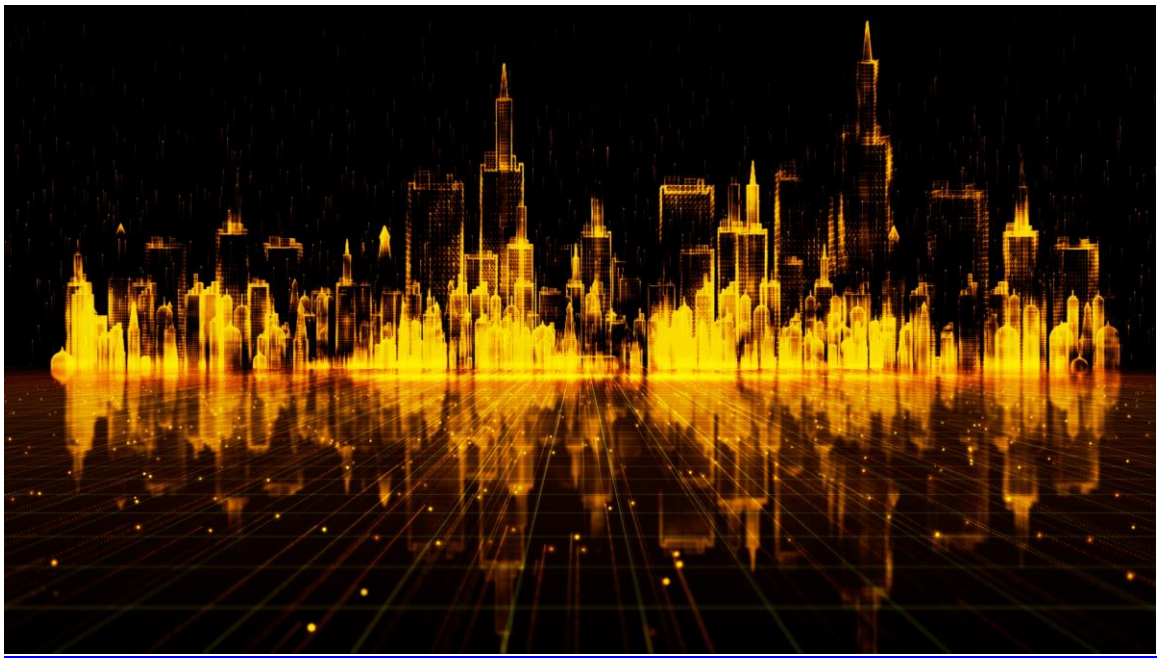


Basel iii News, January 2021

Dear members and friends,

Today we will start with the keynote speech by Mr. Benoît Cœuré, Head of the BIS Innovation Hub, at the European Stability Mechanism fourth research seminar of the Regional Financing Arrangements.

The financial system after Covid-19

Introduction

Distinguished guests, ladies, and gentlemen,

Thank you for inviting me. It is a pleasure to join you virtually today at the fourth research seminar of the Regional Financing Arrangements. And, as a topic, the financial sector landscape post-Covid-19 could not be more timely.

The year 2020 will go down in history as one of the last century's most serious health crises and global economic contractions. The swift response of governments, central banks, and supervisors to mitigate the immediate impact on the real economy has stabilised what could have been catastrophic for global markets.

With mass vaccinations in sight, the policy focus is now shifting from liquidity provision and stabilisation to addressing the long-term scars of the

crisis: enabling capital and labour reallocation across industries, and avoiding permanent output losses.

For such reallocation to happen, and to address longerterm sustainability challenges, we need a financial system which is fit for purpose. Could Covid-19 give us the chance to strengthen it?

In my remarks today, I will argue that we first need to draw the lessons of the crisis, and I will focus on two dimensions.

First, there are the known challenges. The reforms after the Great Financial Crisis (GFC) had the effect of pushing risks outside the banking system, as non-bank financial intermediaries (NBFIs) started to fill in the gaps.
We knew it before Covid-19 and the crisis has confirmed it. What does this tell us about the resilience of this new system? Second, there are the unknown challenges.

The crisis has speeded the digitalisation of our economies, accelerating shifts in how companies and individuals work, save and spend. How can technology support the digitalisation of the financial sector post-Covid-19, and can it help regulators make the sector safe and sustainable?

The lessons of Covid-19 for financial sector resilience

Spurred by regulators, banks have built capital and liquidity buffers, improved risk management practices and internalised the social cost of risk-taking. Thanks to these efforts, they were better prepared to cope with a shock in 2020 than they were in 2008.

The jury is still out as to whether all this will suffice to prevent the initial liquidity crisis from morphing into a solvency one. While the scale is unclear at this stage, economic growth and forwardlooking indicators of default risk already suggest that bankruptcies will rise significantly by the end of 2021.

On the other hand, credit spreads are fairly tight, raising concerns about a possible disconnect with fundamentals.

Looking ahead, it will be essential that banks make use of the available capital buffers to absorb losses without excessive deleveraging.

As Carolyn Rogers, the Secretary-General of the Basel Committee on Banking Supervision, recently emphasised, it is too early for banks to take a victory lap over their response to Covid-19.

Holding back on their discretionary distributions of capital makes sense.

Even though the banking sector was not at the epicentre, the turmoil highlighted structural vulnerabilities in the NBFIs sector and the market structures supporting them.

These vulnerabilities have become more important post-GFC, as the footprint of NBFIs has grown – accounting for almost 50% of total financial intermediation globally – and as banks have retreated from certain activities, such as market-making, to preserve balance sheet capacity.

The first weeks of the Covid-1 crisis revealed that the matching and price discovery mechanisms were impaired in large swathes of the capital markets. As conditions worsened, demand soared for cash and near-cash, or short-dated assets. In such circumstances, market liquidity can be as crucial to financial stability as bank solvency or bank liquidity.

As events unfolded, central banks had to intervene to ensure financial stability.

To read more: https://www.bis.org/speeches/sp201217.pdf

Climate-related Financial Disclosures (TCFD)

FSB encourages the IFRS Foundation and authorities to use TCFD's recommendations as the basis for climate-related financial risk disclosures

Globally consistent and comparable disclosures by companies of their climate-related financial risks are increasingly important to market participants and financial authorities as a means to give financial markets the information they need to manage risks, and seize opportunities, stemming from climate change.

The FSB created the Task Force on *Climate-related Financial Disclosures (TCFD)* in 2015 to develop a set of voluntary disclosure recommendations for use by companies in providing decision-useful information to investors, lenders and insurance underwriters about the climate-related financial risks that companies face.

The TCFD published its disclosure recommendations in 2017.

Since then, nearly 1,700 organisations have expressed their support for the TCFD recommendations.

Nearly 60% of the world's 100 largest public companies support the TCFD, report in line with the TCFD recommendations, or both.

The TCFD continues to promote and monitor adoption of its recommendations worldwide and issued supplementary guidance to support implementation.

Alongside this industry-led progress in promoting consistent voluntary climate-related disclosures, a growing number of official sector initiatives are developing requirements or guidance at the national or regional level, or considering the development of international standards.

It is important that steps by the official sector and private sector are well aligned in promoting globally consistent disclosures and avoiding fragmentation.

The FSB therefore welcomes the recommended approach by the Trustees of the IFRS Foundation to initially focus on standards for climate-related financial disclosures, as set out in the September 2020 IFRS Consultation Paper on Sustainability Reporting.

The initial focus on climate-related information would be appropriate given the growing interest of investors in the topic for financial risk management

and the importance of global consistency in the actions that are already beginning to be taken by national and regional authorities to develop requirements and guidance in this area.

Such internationally agreed minimum standards for disclosures would, as usual, not preclude individual authorities from going further if they wish.

The FSB strongly encourages the IFRS Foundation to build on the work of the TCFD, by using the TCFD's recommendations as the basis for standards for climate-related financial disclosures.

The TCFD recommendations set out a comprehensive framework that has been developed by, and is directly responsive to the needs of, users and preparers of financial filings across a range of financial and non-financial sectors around the world.

The TCFD's recommendations have attracted widespread support from users and preparers.

The FSB strongly encourages national or regional authorities that are developing requirements or guidance for climate-related disclosures to consider using the TCFD recommendations as the basis.

Such consistency in approach would help to avoid the risk of market fragmentation, both across jurisdictions, and between requirements and guidance being developed today and international standards that may be introduced in the future.

To further promote global coordination, the FSB will explore with standard-setters and other international bodies ways to promote globally comparable, high-quality and auditable standards of disclosure based on the TCFD recommendations.

The FSB will report to the G20 Finance Ministers and Central Bank Governors meeting on progress in this area in July 2021.

EBA updates reporting framework 3.0 and technical standards on Pillar 3 disclosure

The European Banking Authority (EBA) published an update to the reporting framework 3.0 and the Implementing Technical Standards (ITS) on institutions' Pillar 3 public disclosures.

These updates are the result of the European Commission's adoption of the ITS on Supervisory Reporting (v3.0) on 17 December, the EBA publication of the revised version of the mapping between disclosures and reporting, and the EBA release of phase 1 of its technical package on the reporting framework v3.0.

EC adoption of ITS on Supervisory Reporting (v3.0)

The EBA updated its website to reflect the European Commission's adoption of the Supervisory Reporting Implementing Act and its Annexes, which included changes introduced by the revised Capital Requirements Regulations (CRR2) and the Prudential Backstop Regulation.

Mapping between Pillar 3 ITS on Disclosures and ITS on Supervisory Reporting (v3.0)

The Pillar 3 ITS on institutions' public disclosures have been developed to foster consistency across supervisory reporting.

The EBA has updated the mapping of quantitative disclosure data and supervisory reporting, which aims at facilitating institutions' compliance and improving the consistency and quality of the information disclosed.

The EBA also published a file summarizing the frequency at which each type of institution should disclose each template and table, in accordance with the CRR2.

Phase 1 of technical package of reporting framework (v3.0)

The technical package of the reporting framework provides the standard specifications for the implementation of the EBA reporting requirements.

The package includes the validation rules, the Data Point Model (DPM) data dictionary and the XBRL taxonomies for v3.0.

The EBA also updated the DPM query tool. Finally, the technical package includes reporting requirements on FINREP, COREP, own funds (including

the Fundamental Review of the Trading Book - FRTB), COREP liquidity, asset encumbrance, large exposures, leverage ratio and G-SII data.

To read more:
https://eba.europa.eu/eba-updates-reporting-framework-30-and-technical-standards-pillar-3-disclosure

Guidance issued as SolarWinds compromised

SolarWinds, a popular IT system management platform has been compromised and could be used for further attacks on connected systems.

As a result of a cyber attack of their systems, an attacker was able to add a malicious modification to SolarWinds Orion products which allows them to send administrator-level commands to any affected installation.

This modification causes the Orion products to connect to an attacker-controlled server to request instructions and does not rely on the attacker being able to directly connect from the internet to the Orion server.

Not all customers who have an installation with the unauthorised, malicious modification will have been seriously affected, but all should take immediate action.

The NCSC has been working closely with international partners as well as FireEye - a cyber security organisation who discovered the compromise.

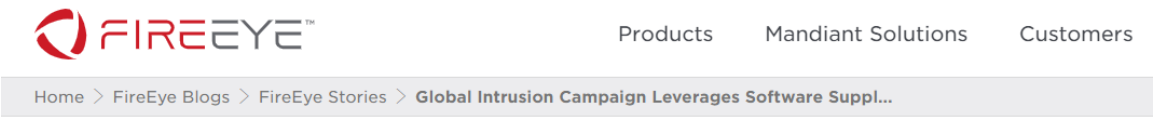
In a statement issued earlier this week, we recommended that organisations ensure any affected instances of SolarWinds Orion are installed behind firewalls disabling internet access (both outbound and inbound) for the instances. The statement:
https://www.ncsc.gov.uk/news/ncsc-statement-on-fireeye-incident

The NCSC has now also published full guidance highlighting immediate actions for all organisations using the SolarWinds Orion suite of IT management tools. You may visit:
https://www.ncsc.gov.uk/guidance/dealing-with-the-solarwinds-orion-compromise

We would also recommend further reading:

1. SolarWinds have published a security advisory on this incident including details of affected software and the vendor's advice. You may visit:
https://www.solarwinds.com/securityadvisory

2. FireEye has published a blog on its investigation. This includes extensive technical details which may help in investigation of a suspected server compromise. You may visit: https://www.fireeye.com/blog/products-and-services/2020/12/global-intrusion-campaign-leverages-software-supply-chain-compromise.html



FireEye Stories

Global Intrusion Campaign Leverages Software Supply Chain Compromise

3. Microsoft has also published a blog on this attack which includes other potential routes for investigation of compromise. You may visit: https://blogs.microsoft.com/on-the-issues/2020/12/13/customers-protect-nation-state-cyberattacks/

FDIC Community Banking Study, December 2020

Eight years ago, coming out of the financial crisis, the FDIC conducted a study of community banks. This study was the first large-scale review of community banks ever conducted, and it recognized the importance of community banks and their unique role in the banking industry.

As a result of that study, the FDIC changed its approach to identifying community banks. In general, community banks are those that provide traditional banking services in their local communities.

As of year-end 2019, there were 4,750 community banks in the country with more than 29,000 branches in communities from coast to coast.

Since the 2012 study, community banks have proven to be resilient. Relative to noncommunity banks, community banks have had faster growth in return on assets ratios, higher net interest margins, stronger asset quality, and higher loan growth rates.

Community banks have continued to demonstrate this strength during the COVID-19 pandemic. The FDIC recognizes the role community banks play in providing loan and deposit services to customers throughout this country, which is why I made this update to the 2012 Community Banking Study a research priority in 2020.

I instructed my research team not only to update key aspects of the prior study, but also to consider new topics that are important to community banks, such as regulatory change and technology.

By continuing to study community banks and providing that research to the public—our stakeholders—we can continue to identify ways that the FDIC can provide support to these institutions. I would like to extend a special thanks to Diane Ellis, Director of the FDIC Division of Insurance and Research, for leading this effort.

I believe this work will provide continued recognition of community banks' strength, their unique role in the banking industry, and their value to the public.

Jelena McWilliams Chairman, FDIC December 2020

Chart 1.1

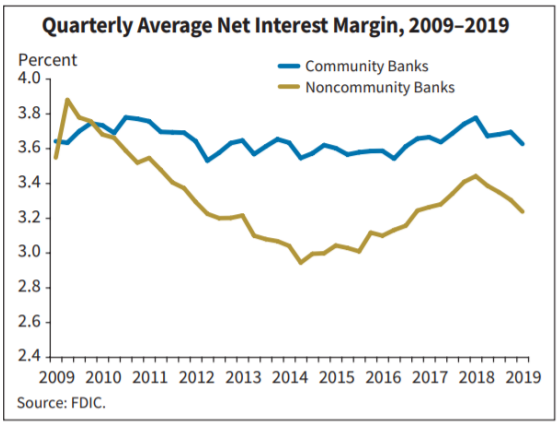


Chart 1.2

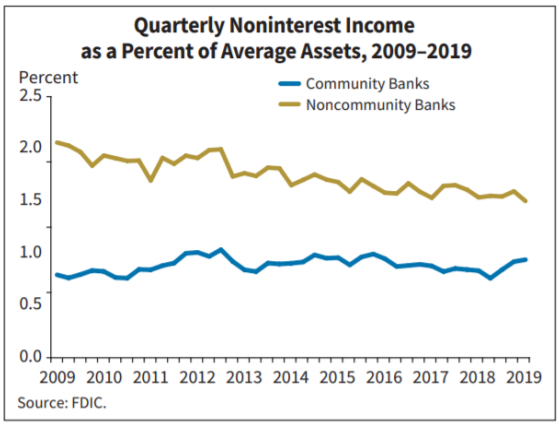


Table 1.2 Assets With Maturities Greater Than 3 Years to Total Assets (Percent)

	2012	2013	2014	2015	2016	2017	2018	2019
All Banks	**28.8**	**29.5**	**30.2**	**31.6**	**32.4**	**32.6**	**32.4**	**33.3**
Community Banks	42.9	47.3	47.9	47.4	47.2	46.8	45.8	44.8
Noncommunity Banks	26.5	26.7	27.5	29.2	30.2	30.5	30.4	31.8

Source: FDIC.

Table 1.3 Noninterest Income at Community and Noncommunity Banks (Percent)

Category of Noninterest Income as a Percent of Total Noninterest Income	Full-Year 2012		Full-Year 2019	
	Community Banks	Noncommunity Banks	Community Banks	Noncommunity Banks
Service Charges on Deposit Accounts	24.3	12.7	18.8	13.1
Fiduciary Income	6.9	11.9	8.0	14.3
Gains on Asset Sales	21.7	3.9	22.0	4.0
Market Sensitive Income[1]	2.6	11.8	3.0	17.6
Securitization Income	0.5	0.6	0.1	0.1
Servicing Income	3.1	4.7	3.7	1.2
Insurance Income	3.3	1.4	3.1	1.7
All Other Noninterest Income[2]	37.5	53.0	41.4	47.9
Total Noninterest Income	**100.0**	**100.0**	**100.0**	**100.0**
Noninterest Income as a Percent of Net Operating Revenue	22.0	39.4	20.2	34.2
Noninterest Income as a Percent of Average Assets	0.95	1.9	0.87	1.5

Source: FDIC.

[1] Includes trading, venture capital, and investment banking income.

[2] Other noninterest income includes service charges, commissions, and fees (such as safe deposit box rentals, money orders and cashiers checks, notarizing of documents, ATM fees, wire transfers), check sales, rental income from other real estate owned, bank-owned life insurance income, annual credit card fees and interchange fees.

Chart 1.3

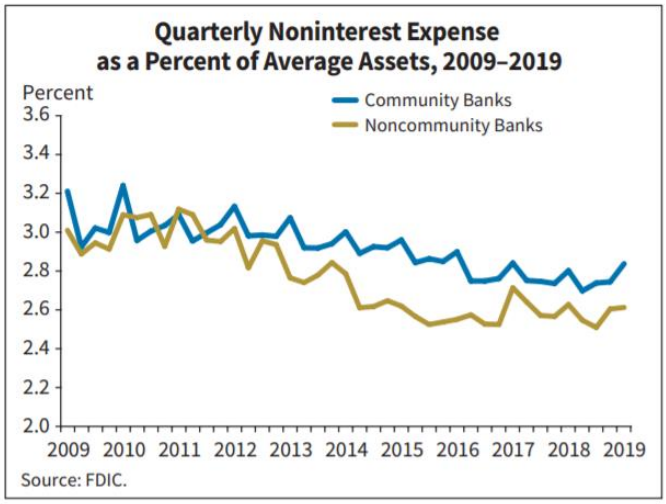


Table 1.4 Compound Annual Growth Rate of Noninterest Expense Categories (Percent)

	Full-Year 2012		Full-Year 2019	
	Community Banks	Noncommunity Banks	Community Banks	Noncommunity Banks
Salary and Employee Benefit Expenses	4.6	7.0	1.4	3.0
Premises and Fixed Asset Expenses	3.2	5.2	-0.8	0.7
Salary + Fixed Asset Expenses	**4.3**	**6.6**	**1.0**	**2.6**
All Other Noninterest Expenses	2.4	4.7	-1.6	0.8
Total Noninterest Expenses	**3.8**	**7.4**	**0.1**	**1.9**
Average Assets	**4.0**	**9.3**	**1.5**	**4.0**

Source: FDIC.

To read the paper (129 pages):
https://www.fdic.gov/resources/community-banking/report/2020/2020-cbi-study-full.pdf

ICO statement in response to UK Government's announcement on the extended period for personal data flows, that will allow time to complete the adequacy process

ICO is the UK's independent authority set up to uphold information rights in the public interest, promoting openness by public bodies and data privacy for individuals.

The Government has announced that the Treaty agreed with the EU will allow personal data to flow freely from the EU (and EEA) to the UK, until adequacy decisions have been adopted, for no more than six months. You may visit:
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/948093/TCA_SUMMARY_PDF.pdf

This will enable businesses and public bodies across all sectors to continue to freely receive data from the EU (and EEA), including law enforcement agencies.

As a sensible precaution, before and during this period, the ICO recommends that businesses work with EU and EEA organisations who transfer personal data to them, to put in place alternative transfer mechanisms, to safeguard against any interruption to the free flow of EU to UK personal data. You may visit:
https://ico.org.uk/for-organisations/data-protection-at-the-end-of-the-transition-period/

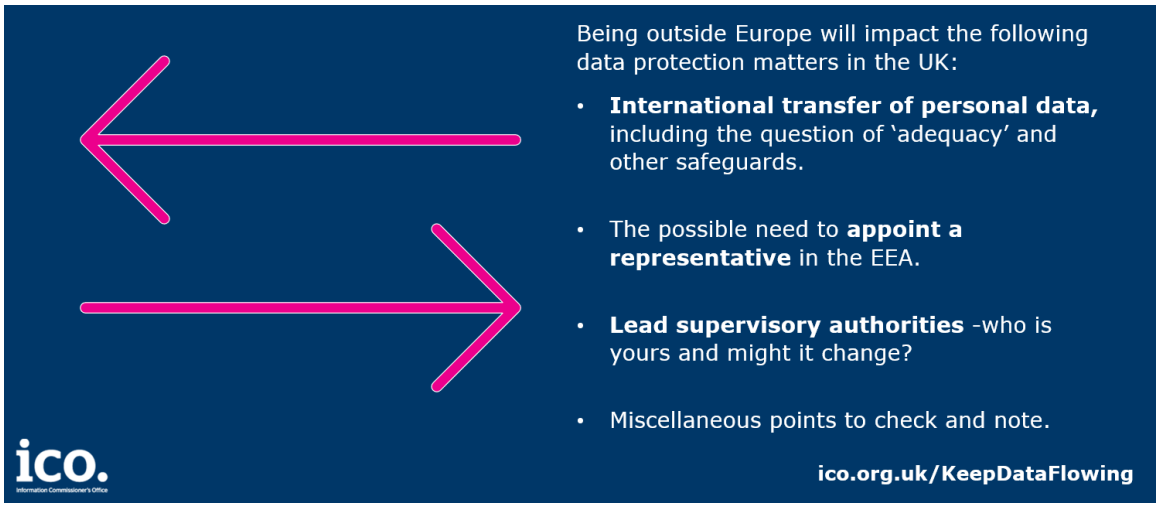
As previously announced, the UK has, on a transitional basis, deemed the EU and EEA EFTA States to be adequate to allow for data flows from the UK.

Information Commissioner, Elizabeth Denham said:

“This is the best possible outcome for UK organisations processing personal data from the EU.”

“This means that organisations can be confident in the free flow of personal data from 1 January, without having to make any changes to their data protection practices.”

“We will be updating the ICO guidance on our website to reflect the extended provisions and ensure businesses know what happens next. At this stage it’s good news for businesses and public bodies.”



Financial Stability Oversight Council (FSOC), Annual Report

The U.S. economy was in the midst of the longest post-war economic expansion, with historically low levels of unemployment, prior to the onset of the COVID-19 pandemic earlier this year.

The global pandemic not only brought about a public health crisis but also caused a contraction of economic activity at an unprecedented pace.

Initially, the pandemic reduced consumer spending, slowed manufacturing production, and led to widespread business closures.

The unemployment rate surged from 3.5 percent in February to a record high of nearly 15 percent in April.

Since then, extraordinary measures undertaken by policymakers have succeeded in arresting the decline in economic conditions, initiating a recovery and lowering the unemployment rate to 7.9 percent as of September.

However, a protracted virus outbreak poses downside risks that can slow the recovery and even prolong the economic downturn.

Financial Stress from the COVID-19 Pandemic and the Policy Response

The COVID-19 outbreak led to substantial financial stress in the first quarter of 2020.

While economic activity was disrupted in March, investors fled riskier assets for the safety and liquidity of cash and shortterm government securities.

A broad-based selloff in equities and commodities resulted in sharp declines in both spot and futures prices.

The sectors most affected by the pandemic, such as airlines, energy, transportation, hotels, and restaurants, recorded the sharpest declines.

The flight to safety and liquidity also created disruptions in short-term and global dollar funding markets.
Meanwhile, trading conditions for Treasuries and agency mortgagebacked securities (MBS), generally considered safe and liquid assets, were also strained.

Moreover, credit conditions tightened in the commercial paper (CP), corporate bond, and municipal debt markets.

With the stress in funding markets in March, precautionary draws by nonfinancial businesses on existing lines of credit with banks increased sharply, as firms tried to cover shortfalls in revenues and reductions in the availability of short-term funding.

Substantially increased liquidity and capital requirements imposed after the 2008 financial crisis helped banks meet the large, unanticipated drawdowns.

Large deposit inflows from investors fleeing to the safety of deposit insurance and borrowings at the Federal Reserve's discount window also helped in meeting this surge in liquidity demand.

Meanwhile, policymakers acted to minimize the health and economic effects of the pandemic.

On March 27, the Coronavirus Aid, Relief, and Economic Security (CARES) Act was signed into law.

The CARES Act authorized approximately $2.6 trillion in funding to address COVID-19 and to support the economy, households, businesses, and other entities.

In addition, the Federal Reserve and Treasury undertook a series of extraordinary measures beginning in March to contain the financial fallout from the pandemic.

The Federal Reserve also lowered the target federal funds rate to near zero and substantially increased purchases of Treasuries and agency MBS to ease trading pressures.

In a bid to stabilize short-term funding markets (STFMs), the Federal Reserve launched a series of facilities to provide liquidity to foreign central banks, primary dealers, depository institutions, and money market funds.

In light of these exigent circumstances, the Federal Reserve and Treasury also enacted a series of unprecedented measures to support corporate bonds, bank loans, longer-term municipal debt, and asset-backed securities.

These credit and lending facilities were developed with the goal of relieving strains in longer-term debt markets through the pandemic.

These policy actions have substantially improved market conditions and investor sentiment in financial markets. Federal Reserve purchases of Treasuries and agency MBS reduced bid-ask spreads and relieved the stress in trading conditions for these securities.

The announcement of liquidity facilities not only succeeded in lowering spreads on CP and short-term municipal securities but also reversed the heavy redemptions from prime and tax-exempt money funds.

The creation of new credit facilities lowered spreads on corporate bonds and revived new issuance in both the investment grade and high-yield bond segments.

Overall, these policy measures have restored the orderly functioning of financial markets and improved investor sentiment, as reflected in the rebound in corporate financing and equity prices.

The Council provided an important venue for facilitating coordination and analysis of risks across member agencies at the onset of the pandemic and throughout the year. Council members regularly identified key risks and shared information regarding their policy responses.

The Council also increased the frequency of staff-level meetings to allow important analyses of major market developments to be shared in a timely manner with all Council member agencies.

In addition, the Council's previous identification of vulnerabilities and analysis that it had performed leading up to the financial stress helped ensure that policymakers' responses were more coordinated, well informed, and effective.

The report (216 pages):
https://home.treasury.gov/system/files/261/FSOC2020AnnualReport.pdf

3.2.2.1 S&P 500 Volatility

Source: Bloomberg, L.P.

Response to COVID-19 and medium- to long-term challenges for Japan's economy - with an eye on the post-COVID-19 era

Haruhiko Kuroda, Governor of the Bank of Japan, at the meeting of Councillors of Nippon Keidanren (Japan Business Federation), Tokyo.

Introduction

It is a great honor to have this opportunity to address such a distinguished gathering of business leaders in Japan today.

For eight years now, I have delivered a speech at this end-of-year meeting, and I can say that this year we have experienced enormous changes in the social and economic environment due to the shock of the novel coronavirus (COVID-19).

As we wrap up 2020, I would first like to take a look back at economic developments this year, mainly focusing on the impact of COVID-19, and talk about the outlook for economic activity and prices.

Then, I will explain the Bank of Japan's thinking behind its policy responses.

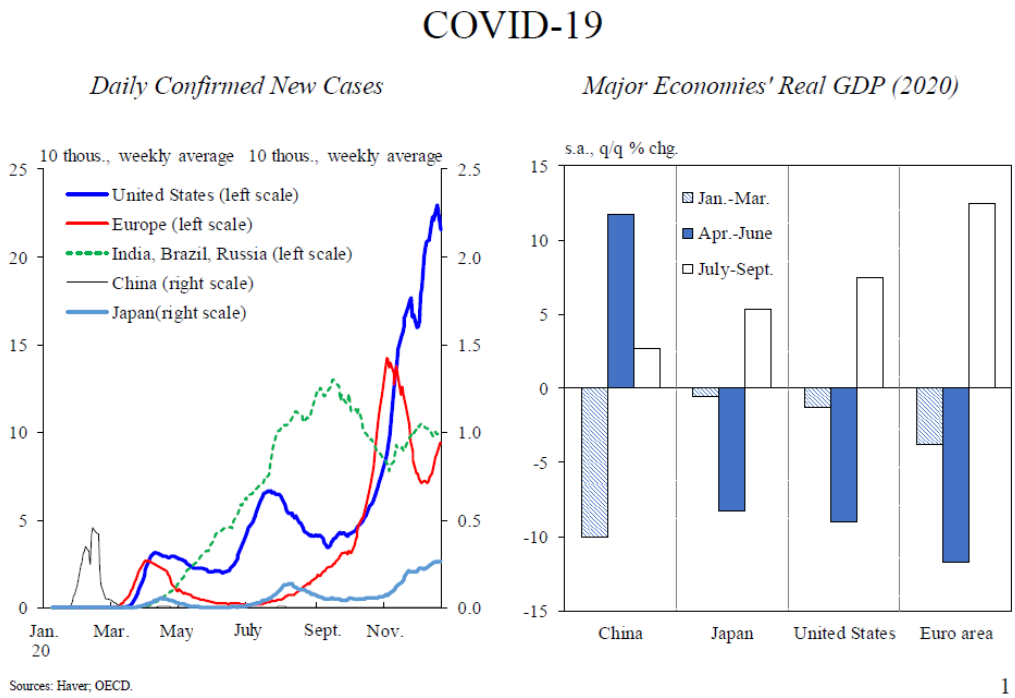
In relation to the conduct of monetary policy, I will also touch on the conduct of the assessment for further effective and sustainable monetary easing, which the Bank decided at the Monetary Policy Meeting (MPM) held last week.

Lastly, I would like to talk about what is necessary in taking advantage of lessons to be learned from overcoming the current crisis for future growth -- that is, challenges regarding Japan's economy as a whole that should be addressed when also looking ahead to the post-COVID-19 era from a medium- to long-term perspective.

I. Economic and Price Developments during the COVID-19 Era and Their Outlook Impact of COVID-19 on the Economy

I. Economic and Price Developments during the COVID-19 Era and Their Outlook

Chart 1



Let me start with a look back at economic developments this year, mainly focusing on the impact of COVID-19.

COVID-19 started to spread from the beginning of the year and became a pandemic within a short period toward early spring (Chart 1).

Governments around the world took strict and wide-ranging public health measures in order to prevent the spread.

Under these circumstances, the global economy became depressed significantly.

However, since the summer season, as public health measures have been eased, the global economy has picked up from that state of significant depression, as seen in the growth rates of each country turning positive on a quarter-on-quarter basis.

Similar developments have been observed in Japan.

The quarter-on-quarter GDP growth rate for the April-June quarter registered a considerably negative figure of minus 8.3 percent with wide-ranging economic activities being constrained.

However, that for the July-September quarter turned positive, to 5.3 percent, and Japan's economy has picked up from the bottom, although it has remained in a severe situation.

The economic fluctuation this time is different in nature from what was seen in the past.

Most of the fluctuations since World War II were triggered by cyclical adjustments in business fixed investment and in inventory investment, or by financial imbalances.

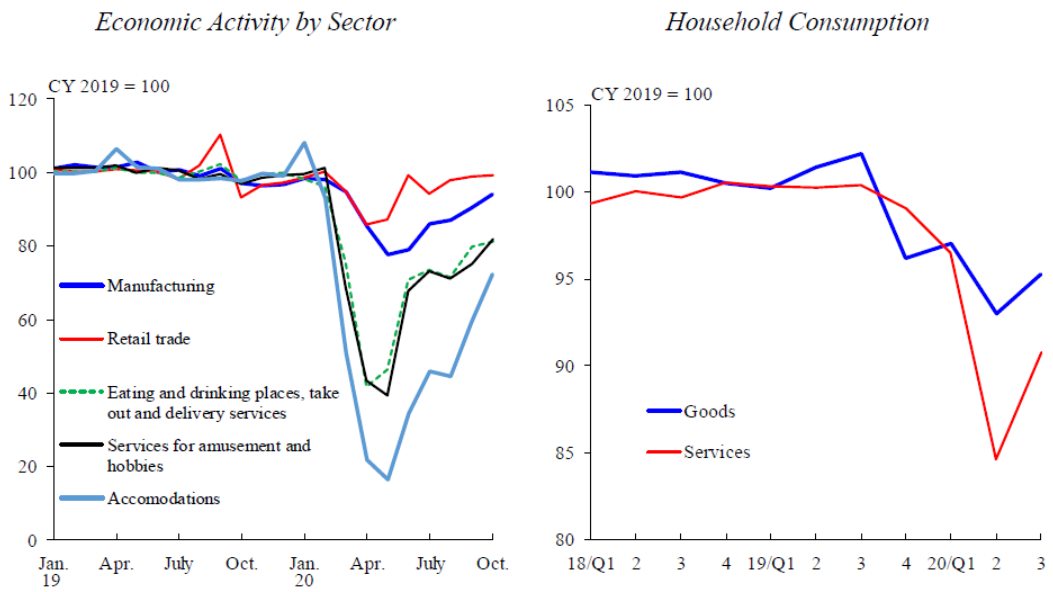
On the other hand, the current fluctuation is exceptional, in that it stemmed from a shock caused by an infectious disease, which is not inherent in the economy, and that economic activity has been constrained exogenously with a view to preventing the spread of the disease.

In other words, such activity has been affected largely by an epidemiologic factor.

I. Economic and Price Developments during the COVID-19 Era and Their Outlook

Chart 2

Impact on Economic Activity



Note: In the left-hand chart, figures for manufacturing are the "Indices of Industrial Production" and those for other sectors are the "Indices of Tertiary Industry Activity."
Sources: Ministry of Economy, Trade and Industry; Cabinet Office.

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Reflecting the characteristics of COVID-19, economic activities that involve social interaction are particularly affected, and this is another point that is unique to the current case (Chart 2).

Looking at economic activities of firms in Japan by sector, a significant decline has been seen in the industry of face-to-face services such as eating

and drinking as well as accommodations -- where firms are relatively small -- and amusement services including events.

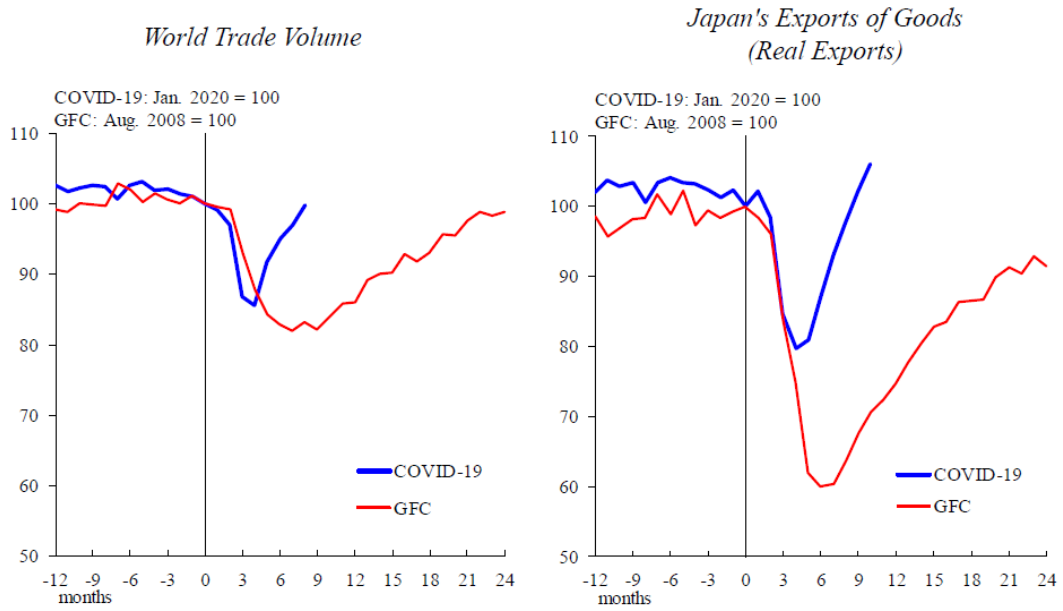
In terms of household spending, consumption of services has declined considerably compared with that of goods. A constraint on services consumption is due to vigilance against COVID-19, and the differences in consumption behavior of each age group reflect the degree of their vigilance.

That is, services consumption by the younger generation has recovered rapidly, whereas that by seniors, who are strongly vigilant against COVID-19, saw a significant decline and has picked up at a slower pace. In contrast, manufacturing and retail firms, which produce and sell goods, have been relatively less affected.

I. Economic and Price Developments during the COVID-19 Era and Their Outlook

Chart 3

Trade Activity of Goods



Sources: CPB Netherlands Bureau for Economic Policy Analysis; Bank of Japan; Ministry of Finance.

3

Goods transactions worldwide have picked up at a comparatively faster pace (Chart 3).

A decline in global trade activity has been small compared with at the time of Global Financial Crisis (GFC) and a rapid recovery has been observed. Under these circumstances, the level of Japan's exports has returned to that seen prior to the COVID-19 outbreak, and at a rapid pace. This has led to manufacturers' relatively steady production activity.

As I have explained thus far, the impact of the shock of COVID-19 is uneven and largely varies for attributes such as the industry and size of firms as well as consumers' ages.

At the current phase in particular, this suggests the need to closely examine economic developments not only by looking at the aggregate or average values of data, but also through analyzing developments in different attributes of each economic entity.

To read more: https://www.bis.org/review/r201228a.pdf

Covid-19 and cyber risk in the financial sector

Bank for International Settlements, Iñaki Aldasoro, Jon Frost, Leonardo Gambacorta, David Whyte

Key takeaways

• The financial sector has been hit by hackers relatively more often than other sectors during the Covid19 pandemic.

• While this has not yet led to significant disruptions or a systemic impact, there are substantial risks from cyber attacks for financial institutions, their staff and their customers going forward.

• Financial authorities are working to mitigate cyber risks, including through international cooperation.

During the Covid-19 pandemic, financial institutions have been at the leading edge of the response to cyber risk.

Their already large exposure to cyber risk has been further accentuated by the move towards more working from home (WFH) and other operational challenges.

This Bulletin serves as a primer on cyber risk and presents initial findings on how the financial sector has met the challenges of the pandemic.

We draw on new data to assess changes in the threat landscape for financial institutions in the pandemic.

Cyber risk: a taxonomy

As the economy and financial system become more digitised, cyber risk is growing in importance.

"Cyber risk" is an umbrella term encompassing a wide range of risks resulting from the failure or breach of IT systems.

According to the FSB Cyber Lexicon (2019), cyber risk refers to "the combination of the probability of cyber incidents occurring and their impact".

A "cyber incident", in turn, is "any observable occurrence in an information system that:

(i) jeopardises the cyber security of an information system or the information the system processes, stores or transmits; or

(ii) violates the security policies, security procedures or acceptable use policies, whether resulting from malicious activity or not".

Cyber risk is one form of operational risk (Aldasoro et al (2020b), CPMI-IOSCO (2016)).

Cyber risks can be classified based on their cause/method, actor, intent and consequence (Aldasoro et al (2020a), Curti et al (2019)).

The causes or methods vary, and include both unintended incidents and intentional attacks.

Examples of the former are accidental data disclosure, and implementation, configuration and processing errors.

Such incidents are frequent. Yet around 40% of cyber incidents are intentional and malicious, rather than accidental, ie they are cyber attacks (Aldasoro et al (2020c)).

Some cyber attacks involve threat actors inserting themselves into a trusted data exchange.

Malware (ie "malicious software") is software designed to cause damage to IT devices and/or steal data (for example, so-called Trojans, spyware and ransomware).

Man-in-the-middle attacks occur when attackers insert themselves into a two-party transaction (Graph 1, first panel), accessing or manipulating data or transactions.

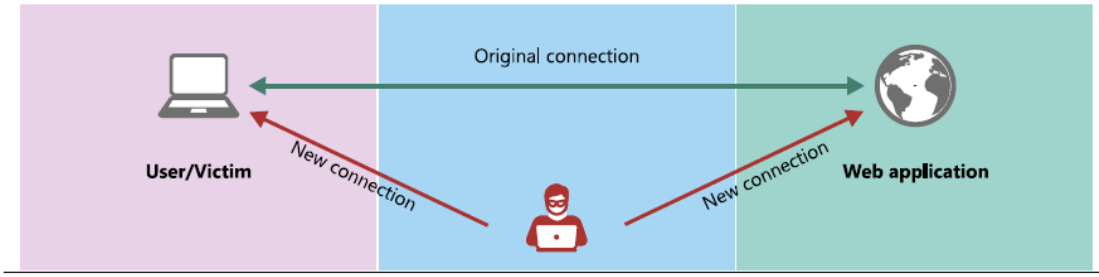
Cross-site scripting is a web security vulnerability that allows attackers to compromise the interactions a victim has with a vulnerable application. Phishing is stealing sensitive data or installing malware with fraudulent emails that appear to be from a trustworthy source (Graph 1, second panel).

To gain a victim's trust, phishing attacks may imitate trusted senders.

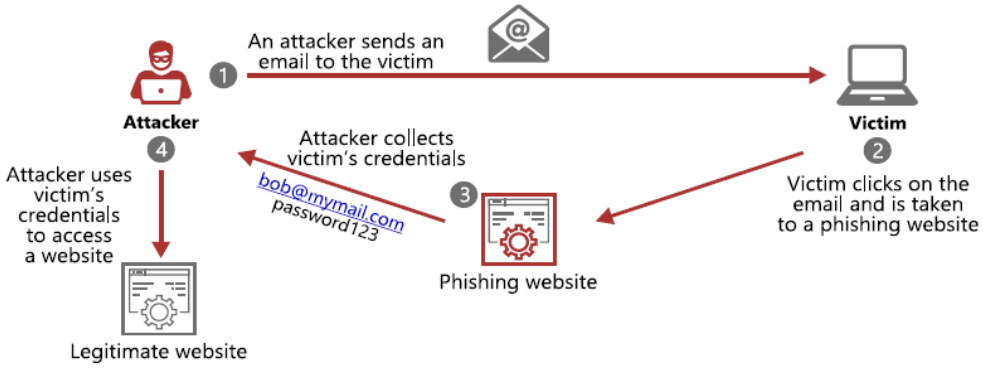
After gaining entrance, these may help attackers to gain credentials and entry into a system.

Selected causes of cyber attacks Graph 1

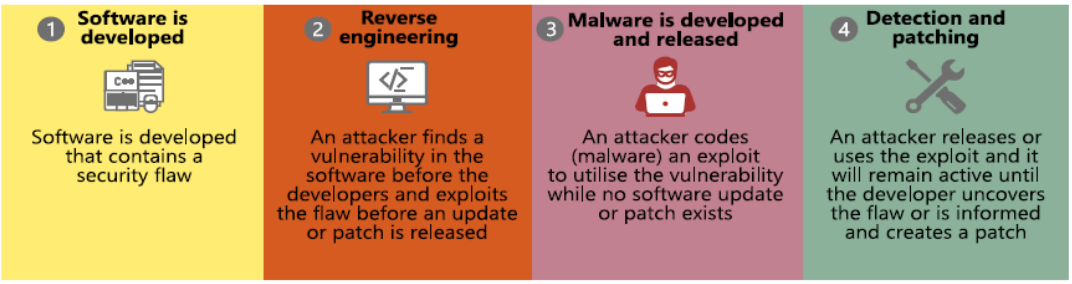
Man-in-the-middle



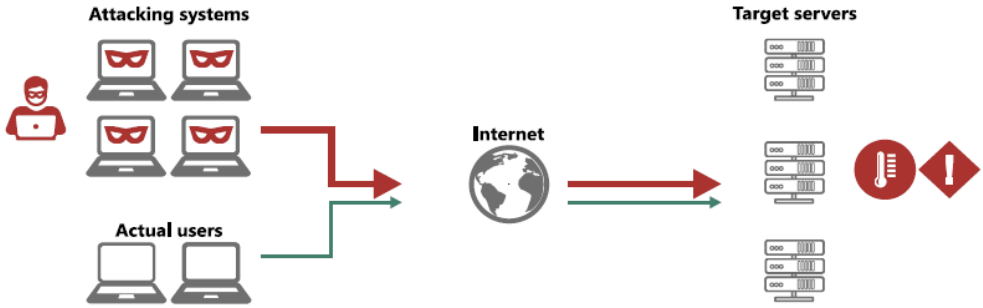
Phishing



Timeline of zero-day vulnerabilities



Distributed denial-of-service (DDoS) attack

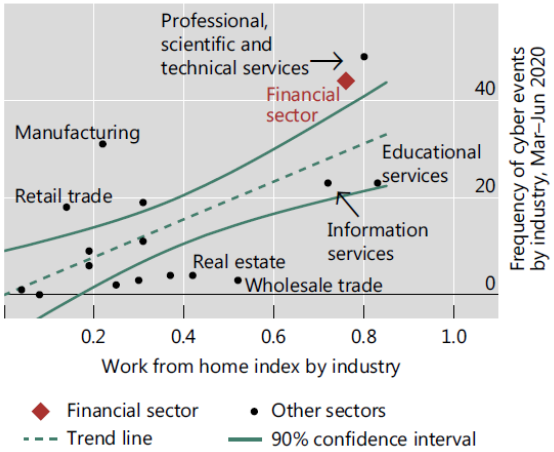


Source: Authors' elaboration.

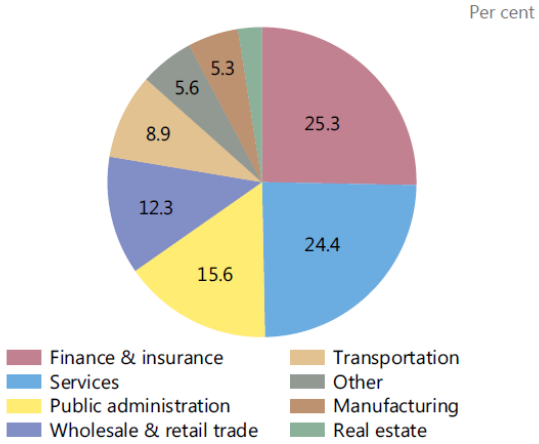
Password cracking is the process of recovering secret passwords stored in a computer system or transmitted over a network.

The financial sector has been hit by cyber attacks during the pandemic — Graph 2

WFH index versus cyber events during Covid-19[1]



Covid-19-related cyber events by sector[2]



[1] Excludes the health sector. [2] Based on cases classified by Advisen as Covid-19-related. Includes data up to 9 September 2020. The sample in the graph excludes the health sector (57 Covid-related cases) and affecting health-related items of the manufacturing sector (163 cases).

Sources: Dingel and Neiman (2020); Advisen; authors' calculations.

To read more: https://www.bis.org/publ/bisbull37.pdf

Reviving and Restructuring the Corporate Sector Post-Covid

The coronavirus pandemic, by dramatically changing consumption patterns and business operations, is triggering a major corporate solvency crisis in many countries.

Apart from policies directly supporting employment, initial policy responses to support businesses focused heavily on liquidity issues. Some liquidity support is still needed, but the crucial issue now is solvency.

Policymakers need to act urgently, as the solvency crisis is already eroding the underlying strength of the business sector in many countries.

The problem is worse than it appears on the surface, as massive liquidity support, and the confusion caused by the unprecedented nature of this crisis, are masking the full extent of the problem, with a “cliff edge” of insolvencies coming in many sectors and jurisdictions as support programs lose funding and existing net worth is eaten up by losses.

However, the difficulty of predicting the duration and recovery path after the pandemic, and of differentiating between structural versus temporary changes in demand, makes it hard to determine the long-term viability of enterprises during the pandemic.

This complicates the targeting and design of measures to support the corporate sector.

This solvency crisis differs sharply from the global financial crisis, which centered on the financial system and on liquidity problems.

Some of the answers from that previous crisis are valid now, but new approaches are also needed.

The first wave of liquidity-focused policy measures has prevented much more severe consequences for the corporate sector, jobs, and for the economy more broadly.

As the crisis progresses, jurisdictions now need to develop policy responses that accommodate structural changes in the economy triggered by the pandemic, and address the following problems that make the initial response unsustainable:

• Inadequate targeting of support, which fails to sufficiently tailor the policy response to the situations of different firms

• An excessive focus on credit provision, which risks overburdening firms with debt, promoting inefficient use of resources, and engendering future problems

• Excessive direct government decision-making and suboptimal use of private sector expertise that could be used to better direct support

• A level of public spending that would be unsustainable over the potential duration of the ongoing economic crisis.

In this report we recommend for policymakers:

• A set of universal core principles to guide the design of the policy response

• A set of potential tools with which to respond

• A decision framework to determine appropriate policy responses for a specific jurisdiction.

To read more:
https://group30.org/images/uploads/publications/G30_Reviving_and_Restructuring_the_Corporate_Sector_Post-Covid.pdf

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