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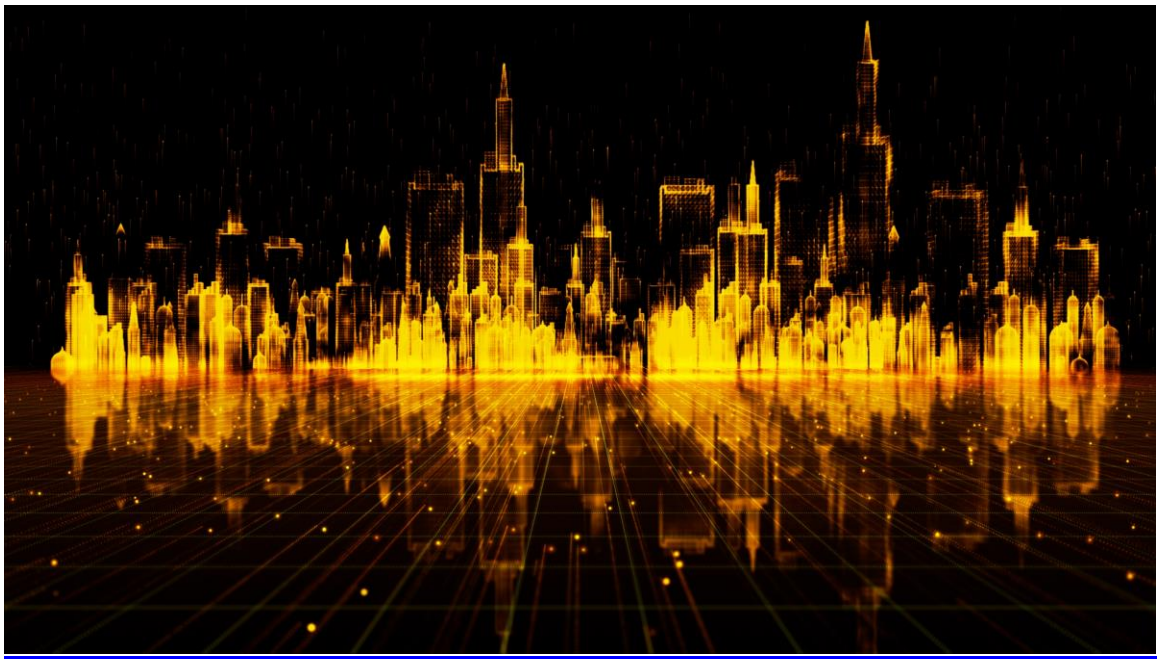

Basel iii News, January 2023

Dear members and friends,

We will start with an assessment of whether and how multilateral platforms could bring meaningful improvements to the cross-border payments ecosystem.

It was written by the Bank for International Settlements' Committee on Payments and Market Infrastructures (CPMI) in collaboration with the BIS Innovation Hub, the International Monetary Fund (IMF) and the World Bank.

The report analyses the potential costs and benefits of these platforms and how they might alleviate some of the cross-border payment frictions. It also evaluates the risks, barriers and challenges to establishing multilateral platforms and explores two paths for their evolution.

The analysis is based on a stocktake, conducted by the CPMI, of existing and potential multilateral platforms as well as bilateral discussions with existing platform operators.

A multilateral platform is a payment system for cross-border payments that is multi-jurisdictional by design. It can substitute for or operate alongside

traditional correspondent banking relationships or bilateral interlinking of domestic payment infrastructures.

A multilateral platform can potentially shorten transaction chains by allowing participants in different jurisdictions to send or receive payments directly instead of via multiple intermediaries.

Depending on its design, a platform can offer extended operating hours to meet the requirements of participants in different time zones and ease compliance checks related to anti-money laundering and combating the financing of terrorism (AML/CFT).

Built as new, it can also reduce dependencies on legacy systems by implementing the latest technology and payment message standards.

To the extent a multilateral platform is able to mitigate these underlying frictions, it could reduce the costs and increase the safety, speed and transparency of cross-border payments.

Multilateral platforms could enhance cross-border payments but often involve more complicated legal and operational issues relative to domestic payment systems.

Any decision to increase the role of multilateral platforms should weigh all relevant trade-offs, risks and benefits relative to other cross-border arrangements such as correspondent banking, not merely the added risks relative to domestic systems.

These considerations vary depending on the current state of cross-border payment arrangements in a specific geographical region or for a specific payment system function, as well as on the purpose and chosen approach for increasing the role of multilateral platforms.

The actual improvements that a potential platform can bring to the cross-border payments ecosystem will, of course, depend on its concrete design. Hence, this report can only offer some high-level considerations, without pre-empting potential future considerations on individual business cases.

This report explores two conceptual implementation approaches: the growth approach and the greenfield approach.

The growth approach involves expanding existing multilateral platforms to additional jurisdictions, currencies and participants (including by extending access to foreign participants and interlinking with domestic systems and other platforms).

This option could be based on existing institutional arrangements but may nevertheless require additional public-private sector involvement and coordination.

The greenfield approach involves building a new, potentially global infrastructure for crossborder payments.

This option could foster greater alignment of certain aspects of cross-border payments but may entail complex governance discussions and cooperative oversight arrangements as well as careful balancing of the roles of public and private sector stakeholders.

Policymakers have different options to consider as they analyse the potential development and implementation of multilateral platforms.

Any evaluation should carefully consider the trade-offs of multilateral platforms and account for the evolving nature of the cross-border payments market. To this end, possible further measures could entail efforts by regional bodies, operators and/or international organisations to realise the potential of multilateral platforms.

Taking advantage of the momentum generated by the G20 cross-border payments programme, payment system operators and authorities contemplating the expansion or establishment of multilateral platforms can use this analysis as a basis for evaluating the best approach for their specific circumstances. Such preparatory steps could allow relevant stakeholders to gain a sound basis from which to plan and assess future actions.

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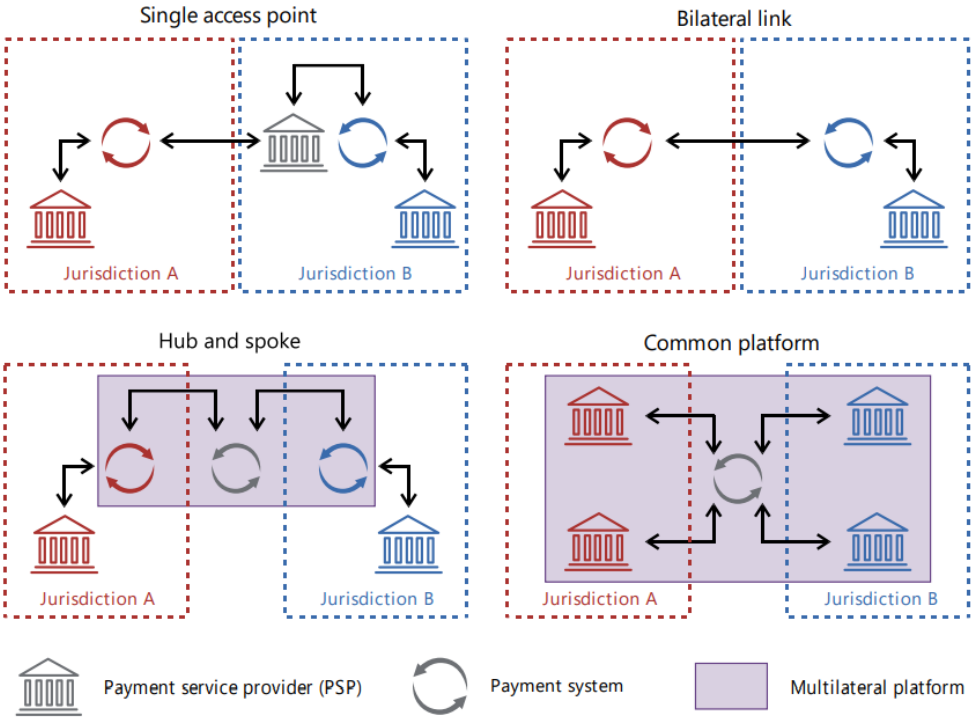
Stylised models for interlinking cross-border payment systems[1, 2] Graph 1



[1] Examples include euroSIC (single access point), Directo a México (bilateral link), the Regional Payment and Settlement System (REPSS) of the Common Market for Eastern and Southern Africa (hub and spoke) and Southern African Development Community (SADC)-RTGS (common platform). [2] The multilateral platform includes the participants and the entity operating the arrangement. In the hub and spoke model, the participants are payment systems. In the common platform model, the participants are PSPs.

Source: Adapted from CPMI (2022d).

To read more: https://www.bis.org/cpmi/publ/d213.pdf

Implementation of G20 Non-Bank Financial Intermediation Reforms, Progress report

This report describes progress in implementing reforms that had been agreed by the G20 following the 2008 global financial crisis to strengthen the oversight and regulation of non-bank financial intermediation (NBFI). The implementation status in various NBFI areas is as follows:

1. Jurisdictions have made progress in implementing Basel III reforms to mitigate spillovers between banks and non-bank financial entities, but implementation is not yet complete.

Four jurisdictions have yet to implement applicable risk-based capital requirements for banks' investments in the equity of funds or the supervisory framework for measuring and controlling banks' large exposures.

2. Adoption of the 2012 IOSCO recommendations to reduce the run risk of money market funds (MMFs) is most advanced in the largest MMF markets.

All FSB members adopted the fair value approach for valuation of MMF portfolios, though one jurisdiction does not have in place requirements for use of the amortised cost method only in limited circumstances.

Progress in liquidity management is less advanced. An IOSCO review found that the policy measures in nine jurisdictions representing about 95% of global net MMF assets are generally in line with the IOSCO recommendations.

3. Adoption of the IOSCO recommendations on incentive alignment approaches for securitisation and of the BCBS standard on revised securitisation framework is ongoing.

About one-third of FSB jurisdictions (for the IOSCO recommendations) and one-sixth of FSB jurisdictions (for the BCBS standard) have yet to implement them.

4. Implementation of FSB recommendations for dampening procyclicality and other financial stability risks associated with securities financing transactions (SFTs) is incomplete and continues to face significant delays in most jurisdictions. On global SFT data collection and aggregation, a few FSB jurisdictions are submitting data to the BIS.

5. Implementation of most FSB recommendations to assess and mitigate systemic risks posed by other non-bank financial entities and activities is ongoing.

The FSB and IOSCO assessed the implementation and effectiveness of their respective recommendations to address liquidity mismatch in open-ended funds (OEFs).

The FSB found that authorities have made meaningful progress in implementing the 2017 FSB Recommendations, but that lessons learnt since then have produced new insights into liquidity management challenges in segments of the OEF sector.

While the assessment suggests that the FSB Recommendations remain broadly appropriate, enhancing clarity and specificity on the policy outcomes the FSB Recommendations seek to achieve would make them more effective from a financial stability perspective.

IOSCO's review of its 2018 Recommendations shows a high degree of implementation of regulatory requirements consistent with the Recommendations' objectives, but some areas may warrant further attention.

In addition to these reforms, the FSB is carrying out further analytical and policy work to enhance the resilience of the NBFI sector, building on the lessons from the March 2020 market turmoil.

To read more: https://www.fsb.org/wp-content/uploads/P180123.pdf

SEC Proposes Rule to Prohibit Conflicts of Interest in Certain Securitizations

The Securities and Exchange Commission proposed a rule to implement Section 27B of the Securities Act of 1933, a provision added by Section 621 of the Dodd-Frank Act.

The rule is intended to prevent the sale of asset-backed securities (ABS) that are tainted by material conflicts of interest.

Specifically, the rule would prohibit securitization participants from engaging in certain transactions that could incentivize a securitization participant to structure an ABS in a way that would put the securitization participant's interests ahead of those of ABS investors.

The Commission originally proposed a rule to implement Section 27B in September 2011.

“I am pleased to support this re-proposed rule as it fulfills Congress’s mandate to address conflicts of interests in the securitization market, which contributed to the 2008 financial crisis,” said SEC Chair Gary Gensler.

“This re-proposed rule is designed to help address conflicts of interest arising with market participants taking positions against investors’ interests. Further, as required by Section 621 of the Dodd-Frank Act, the re-proposed rule provides exceptions for risk-mitigating hedging activities, bona fide market making, and certain liquidity commitments. These changes, taken together, would benefit investors and our markets.”

If adopted, new Securities Act Rule 192 would prohibit an underwriter, placement agent, initial purchaser, or sponsor of an ABS, including affiliates or subsidiaries of those entities, from engaging, directly or indirectly, in any transaction that would involve or result in any material conflict of interest between the securitization participant and an investor in such ABS.

Under the proposed rule, such transactions would be “conflicted transactions.” They include, for example, a short sale of the ABS or the purchase of a credit default swap or other credit derivative that entitles the securitization participant to receive payments upon the occurrence of specified credit events in respect of the ABS. The prohibition on conflicted transactions would commence on the date on which a person has reached,

or has taken substantial steps to reach, an agreement that such person will become a securitization participant with respect to an ABS, and it would end one year after the date of the first closing of the sale of the relevant ABS.

The proposed rule would provide certain exceptions for risk-mitigating hedging activities, bona fide market-making activities, and certain commitments by a securitization participant to provide liquidity for the relevant ABS.

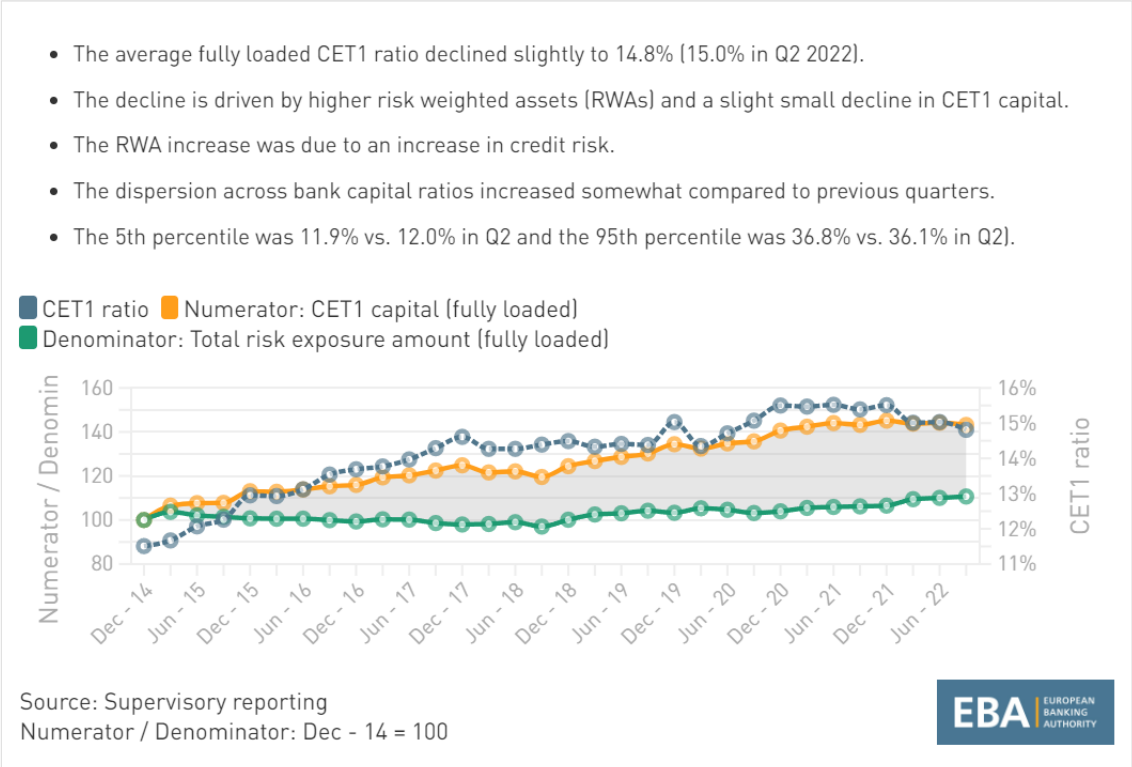
The proposed exceptions would focus on distinguishing the characteristics of such activities from speculative trading. The proposed exceptions would also seek to avoid disrupting current liquidity commitment, market-making, and balance sheet management activities.

The public comment period will remain open for 60 days following publication of the proposing release on the SEC's website or 30 days following publication of the proposing release in the Federal Register, whichever period is longer.

To read more: https://www.sec.gov/news/press-release/2023-17

EBA Risk Dashboard shows that capital and liquidity ratios remain robust

The European Banking Authority (EBA) published its quarterly Risk Dashboard together with the results of the autumn edition of the Risk Assessment Questionnaire (RAQ).



- Overall, banks maintain robust capital and liquidity ratios.

- The average Common Equity Tier 1 (CET1) ratio declined slightly to 14.8% from 15% in the previous quarter on a fully loaded basis.

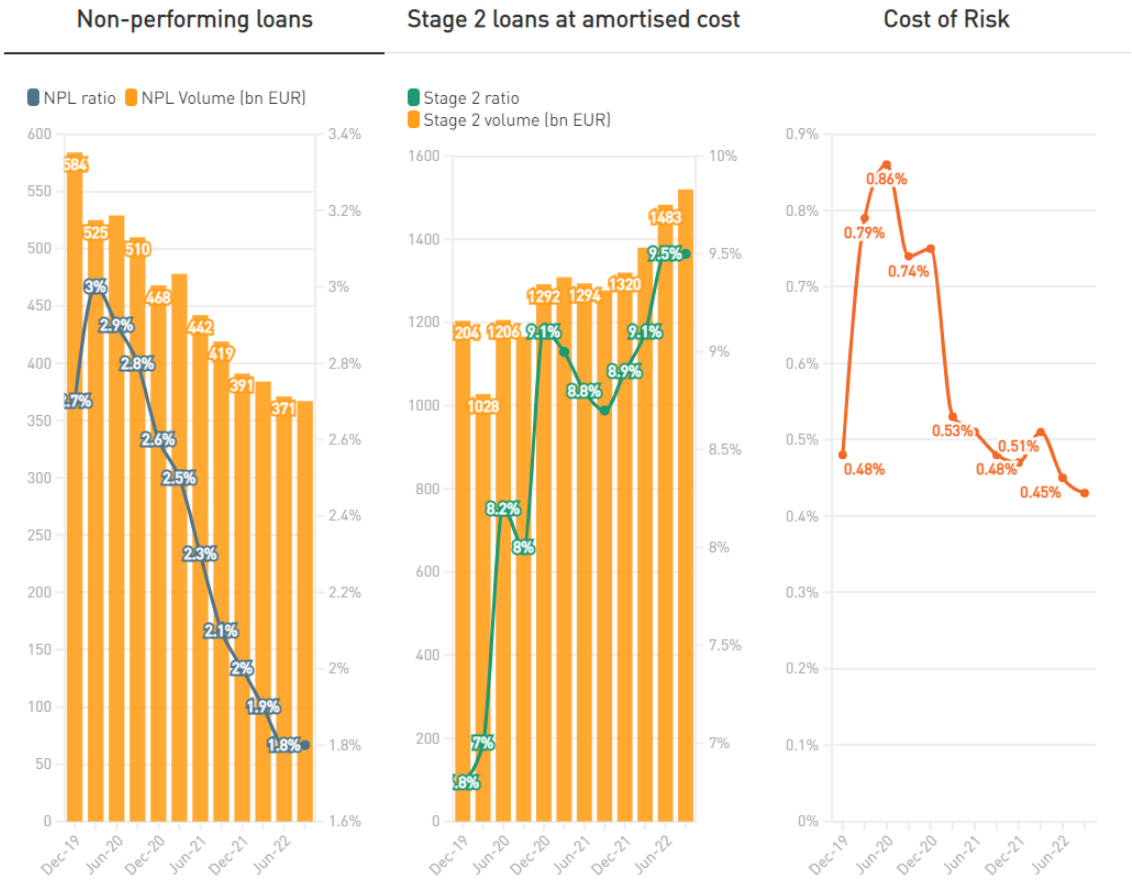
- The average Liquidity Coverage Ratio (LCR) reached 162.5% (164.9% in Q2 2022) while the average Net Stable Funding Ratio (NSFR) remained at 126.9%.

- The non-performing loan (NPL) ratio declined slightly to just below 1.8%. However, banks' asset quality expectations have further deteriorated, notably for SME and consumer finance.

- Average return on equity (RoE) remains stable supported by increases in net interest income

- Banks and analysts remain optimistic about profitability prospects.

- EU Taxonomy used by banks engaged in green lending



To read more:
https://www.eba.europa.eu/eba-risk-dashboard-shows-capital-and-liquidity-ratios-remain-robust

Irving Fisher Committee on Central Bank Statistics

On 9 January 2023 the BIS All Governors' meeting approved the publication of the 2022 Annual Report of the Irving Fisher Committee on Central Bank Statistics (IFC).

It provides a brief update on the IFC's governance and a review of its main workstreams, including planned initiatives.

Members of the IFC Executive as of January 2023

Executive member	Institution	Term
Pablo García (Chair)	Central Bank of Chile	2022–25[2]
Yakubu Aminu Bello	Central Bank of Nigeria	2021–25
Elizabeth Holmquist	Board of Governors of the Federal Reserve System	2022–24
Robert Kirchner	Deutsche Bundesbank	2020-25
Ko Nakayama	Bank of Japan	2020–24
Li Ming Ong	Central Bank of Malaysia	2020–23
Gloria Peña	Central Bank of Chile	2019–24
Fernando Alberto Rocha	Central Bank of Brazil	2018–24
Eyal Rozen	Bank of Israel	2021–23
Silke Stapel-Weber	European Central Bank	2019–24
Luís Teles Dias	Banco de Portugal	2022–24

Executive summary

As a global network that discusses and develops statistical issues of interest to central banks, the IFC now has 98 members and is an affiliated member of the International Statistical Institute (ISI).

It is chaired by Pablo García, Vice Governor of the Central Bank of Chile. One notable feature last year was the decision to host the central bank network on historical monetary and financial statistics (HMFS) under the IFC umbrella.

This group brings together central bank statisticians and academic experts to focus on long-run historic monetary and financial data that are relevant to policymakers.

Another important development for the Committee was related to the international cooperation framework under the Data Gaps Initiative (DGI) endorsed by the G20.

The IFC has continued to actively support the remaining work decided in response to the Great Financial Crisis (GFC) of 2007–09 and to help to coordinate national work on financial data sets.

It is also contributing to the new phase of the DGI initiated in 2022 that calls for better data to understand climate change, income and wealth, financial innovation and inclusion, and access to private and administrative data and data-sharing, to make official statistics more detailed and timely.

In addition, IFC member central banks and the BIS have been actively participating in the ongoing revision of the international statistical manuals (covering the System of National Accounts (SNA) and balance of payments (BPM)) and supporting the global legal entity identification (LEI) system and the Statistical Data and Metadata eXchange standard (SDMX).

The main areas covered by the IFC last year, thanks to the support of its member central banks, the ISI and a number of international organisations, centred on:

• *Post-pandemic landscape for central bank statistics:* the Committee continued to update its web page for Covid-19 statistical resources, which details related official projects and relevant experiences. Moreover, the IFC 11th biennial Conference held in August 2022 was an opportunity to reflect on the new normal for official statistics looking forward.

• *Managing (big) data:* the IFC furthered its analyses of the use of big data in central banks and on the contribution that machine learning (ML) in particular can make. In addition, the Committee has set up recurrent workshops on “Data science in central banking” to review developments in the big data ecosystem and the ongoing adoption of data analytics.

• *Governance of official statistics including communication issues:* the Committee has promoted the establishment of strong data governance standards and co-organised with Banco de Portugal a conference focusing on communication in official statistics.

• *Fintech:* IFC work has continued to document how fintech is transforming the financial landscape, creating a number of challenges for statisticians.

The Committee also participated in the related global consultation on the revised structure of the International Standard Industrial Classification.

• *Sustainable finance:* the IFC has launched a number of initiatives on sustainable finance, including a publication in 2022 on the development of statistics in the environmental, social and governance (ESG) area.

In 2023, the IFC will continue to promote knowledge-sharing and international cooperation on statistics-related methodologies, initiatives and training, reflecting the important role played by central banks in the production of official statistics.

To this end, the eBIS-restricted network on statistical methodological issues has been complemented by the launch of a dedicated public IFC knowledge centre webpage that includes guidance notes and related methodological and training information.

In addition, the Committee will further its work in the various areas outlined above, and a number of events will be organised in this context with the support of the central banks of Canada, Italy and South Africa. A major one will be the ISI's 64th biennial World Statistics Congress (WSC) in Canada.

To read more: https://www.bis.org/ifc/publ/ifc_ar2022.pdf

Pilot Climate Scenario Analysis Exercise

Participant Instructions, January 2023

Executive Summary

The Board is conducting a pilot CSA exercise to learn about large banking organizations' climate risk-management practices and challenges and to enhance the ability of both large banking organizations and supervisors to identify, measure, monitor, and manage climate-related financial risks.

To accomplish these objectives, the Board designed the pilot CSA exercise to gather qualitative and quantitative information about the climate risk-management practices of large banking organizations.

Over the course of the exercise, the Board will engage with participants to understand their approaches and challenges with respect to the financial risks of climate change.

Information collected and discussed with participants will include detailed documentation of governance and risk-management practices, measurement methodologies, data challenges and limitations, estimates of the potential impact on specific portfolios, and lessons learned from this exercise that could inform any future CSA exercises.

The pilot CSA exercise comprises two separate and independent modules: a physical risk module and a transition risk module.

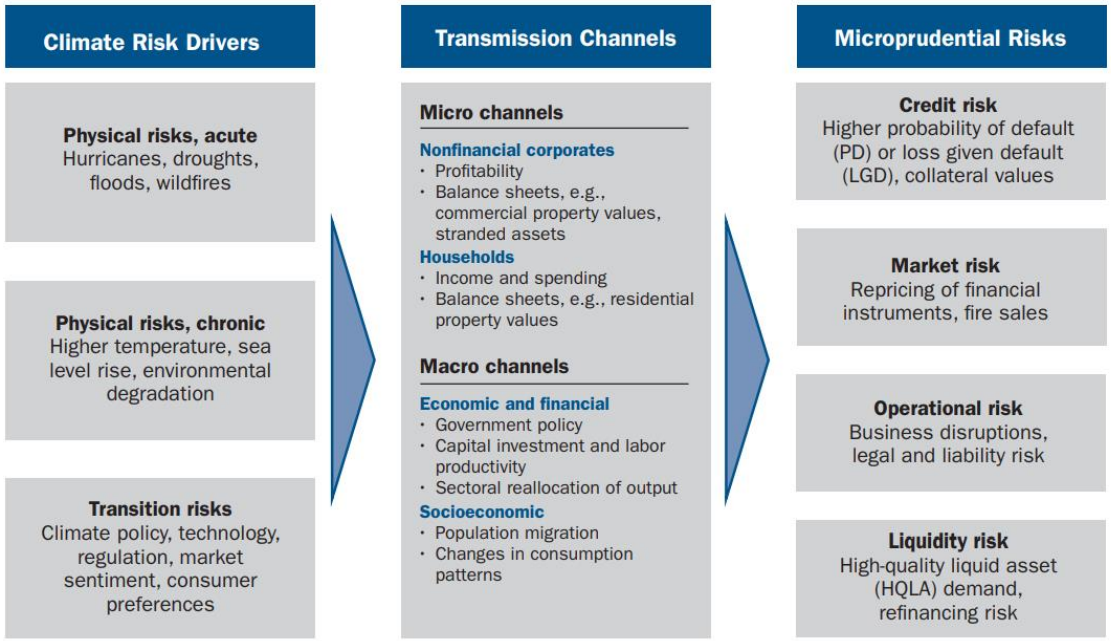
Physical risks represent the harm to people and property that may result from climate-related events, while transition risks represent stresses that may result from the transition to a lower carbon economy.

Both can manifest as traditional prudential risks for large banking organizations.

For both the physical and transition risk modules, the Board will describe forward-looking scenarios to participating large banking organizations, including core climate, economic, and financial variables, where appropriate.

Figure 1. Climate risk drivers manifest as prudential risks

Climate risk drivers could bring about microprudential risks to supervised financial institutions. These risks may manifest through a variety of transmission channels.



Note: Examples are indicative and not exhaustive.

In selecting scenarios for this exercise, the Board leveraged existing work conducted by the Intergovernmental Panel on Climate Change (IPCC) and the Network of Central Banks and Supervisors for Greening the Financial System (NGFS).

The climate scenarios used in the CSA exercise are neither forecasts nor policy prescriptions. They do not necessarily represent the most likely future outcomes or a comprehensive set of possible outcomes.

Rather, the pilot CSA exercise includes a range of plausible future outcomes that can help build understanding of how certain climate-related financial risks could manifest for large banking organizations and how these risks may differ from the past.

Participants will estimate the effect of these scenarios on a relevant subset of their loan portfolios over a future time horizon.

For each loan, participants will calculate and report to the Board credit risk parameters, such as probability of default (PD), internal risk rating grade (RRG), and loss given default (LGD), as appropriate.
Participants will respond to qualitative questions describing their governance, risk-management practices, measurement methodologies, results for specific portfolios, and lessons learned.

Focusing on changes to risk metrics like PD, RRG, and LGD, rather than on estimates of losses, will provide information about how the relative riskiness of exposures within participants' credit portfolios may evolve over time in response to different climate scenarios.

Loss estimates would involve additional assumptions around the evolution of participants' balance sheets and business models and would be incomplete given the partial nature of the exercise, which focuses on specific regions and certain portfolios for six participants.

Six U.S. bank holding companies (BHCs) will participate in this pilot exercise: Bank of America Corporation; Citigroup Inc.; The Goldman Sachs Group, Inc.; JPMorgan Chase & Co.; Morgan Stanley; and Wells Fargo & Company.

These six banking organizations will submit completed data templates, supporting documentation, and responses to qualitative questions to the Federal Reserve Board by July 31, 2023. The Board anticipates publishing insights gained from this pilot exercise around the end of 2023.

The Board expects to disclose aggregated information about how large banking organizations are incorporating climate-related financial risks into their existing risk-management frameworks.

Consistent with the objectives and design of the pilot exercise, the Board does not plan to disclose quantitative estimates of potential losses resulting from the scenarios included in the pilot exercise. No firm-specific information will be released.

This pilot CSA exercise will support the Board's responsibilities to ensure that supervised institutions are appropriately managing all material risks, including financial risks related to climate change.

To read more:
https://www.federalreserve.gov/publications/files/csa-instructions-20230117.pdf

Why Bank Capital Matters

Board of Governors of the Federal Reserve System, Vice Chair for Supervision Michael S. Barr, at the American Enterprise Institute, Washington, D.C.

In my first speech as Vice Chair for Supervision in September, I said that the Federal Reserve Board would soon engage in a holistic review of capital standards. My argument, then and now, is that our review of regulatory policy must be a periodic feature of bank oversight.

Banking and the financial system continuously evolve, and regulation must adapt to address emerging risks.

Bank capital is strong, but in doing our review, we should and are being humble about our ability—or that of bank managers—to predict how a future financial crisis might unfold, how losses might be incurred, and what the effect might be on the financial system and our broader economy.

That humility, that skepticism, will serve us well in crafting a capital framework that is enduring and effective. It will help make sure that we do not lose the hard-fought gains in resilience over the past decade and that we prepare for the future.

That review is still underway, and I have no firm conclusions to announce today. Rather, I thought it would be helpful at this early stage to offer my views on capital regulation and the role that capital standards play in helping to advance the safety and soundness of banks and the stability of the financial system.

By "holistic," I mean not looking only at each of the individual parts of capital standards, but also at how those parts may interact with each other—as well as other regulatory requirements—and what their cumulative effect is on safety and soundness and risks to the financial system.

This is not an easy task, because finance is a complex system. And to make the task even harder, we are looking not only at how capital standards are working today, but also how they may work in the future, when conditions are different.

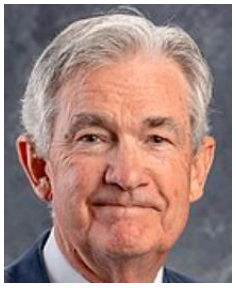
As I mentioned, we are approaching the task with humility—not with the illusion that there is an immutable capital framework to be discovered, but rather, with the awareness that revisions we conceive of today will reflect our current understanding and will inevitably require updating as our understanding evolves.

To read more:
https://www.federalreserve.gov/newsevents/speech/barr20221201a.htm

Watch live:
https://www.aei.org/events/assessing-the-federal-reserves-capital-framework-a-conversation-with-federal-reserve-vice-chair-michael-barr/

Panel on "Central Bank Independence and the Mandate—Evolving Views"

Chair Jerome H. Powell, at the Symposium on Central Bank Independence, Sveriges Riksbank, Stockholm, Sweden



I will address three main points.

First, the Federal Reserve's monetary policy independence is an important and broadly supported institutional arrangement that has served the American public well.

Second, the Fed must continuously earn that independence by using our tools to achieve our assigned goals of maximum employment and price stability, and by providing transparency to facilitate understanding and effective oversight by the public and their elected representatives in Congress.

Third, we should "stick to our knitting" and not wander off to pursue perceived social benefits that are not tightly linked to our statutory goals and authorities.

Central bank independence and transparency

On the first point, the case for monetary policy independence lies in the benefits of insulating monetary policy decisions from short-term political considerations.

Price stability is the bedrock of a healthy economy and provides the public with immeasurable benefits over time. But restoring price stability when inflation is high can require measures that are not popular in the short term as we raise interest rates to slow the economy.

The absence of direct political control over our decisions allows us to take these necessary measures without considering short-term political factors. I believe that the benefits of independent monetary policy in the U.S. context are well understood and broadly accepted.

In a well-functioning democracy, important public policy decisions should be made, in almost all cases, by the elected branches of government. Grants of independence to agencies should be exceedingly rare, explicit, tightly

circumscribed, and limited to those issues that clearly warrant protection from short-term political considerations.

With independence comes the responsibility to provide the transparency that enables effective oversight by Congress, which, in turn, supports the Fed's democratic legitimacy.

At the Fed, we treat this as an active, not passive, responsibility, and over the past several decades we have steadily broadened our efforts to provide meaningful transparency about the basis for, and consequences of, the decisions we make in service to the American public.

We are tightly focused on achieving our statutory mandate and on providing useful and appropriate transparency.

Sticking to our mandate

It is essential that we stick to our statutory goals and authorities, and that we resist the temptation to broaden our scope to address other important social issues of the day. Taking on new goals, however worthy, without a clear statutory mandate would undermine the case for our independence.

In the area of bank regulation, too, the Fed has a degree of independence, as do the other federal bank regulators. Independence in this area helps ensure that the public can be confident that our supervisory decisions are not influenced by political considerations.

Today, some analysts ask whether incorporating into bank supervision the perceived risks associated with climate change is appropriate, wise, and consistent with our existing mandates.

Addressing climate change seems likely to require policies that would have significant distributional and other effects on companies, industries, regions, and nations. Decisions about policies to directly address climate change should be made by the elected branches of government and thus reflect the public's will as expressed through elections.

At the same time, in my view, the Fed does have narrow, but important, responsibilities regarding climate-related financial risks. These responsibilities are tightly linked to our responsibilities for bank supervision.

The public reasonably expects supervisors to require that banks understand, and appropriately manage, their material risks, including the financial risks of climate change.

But without explicit congressional legislation, it would be inappropriate for us to use our monetary policy or supervisory tools to promote a greener economy or to achieve other climate-based goals.7 We are not, and will not be, a "climate policymaker."

To read more:
https://www.federalreserve.gov/newsevents/speech/powell20230110a.htm

Agencies issue joint statement on crypto-asset risks to banking organizations

Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency

The Board of Governors of the Federal Reserve System (Federal Reserve), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) (collectively, the agencies) are issuing the following statement on crypto-asset1 risks to banking organizations.

The events of the past year have been marked by significant volatility and the exposure of vulnerabilities in the crypto-asset sector. These events highlight a number of key risks associated with crypto-assets and crypto-asset sector participants that banking organizations should be aware of, including:

- Risk of fraud and scams among crypto-asset sector participants.

- Legal uncertainties related to custody practices, redemptions, and ownership rights, some of which are currently the subject of legal processes and proceedings.

- Inaccurate or misleading representations and disclosures by crypto-asset companies, including misrepresentations regarding federal deposit insurance, and other practices that may be unfair, deceptive, or abusive, contributing to significant harm to retail and institutional investors, customers, and counterparties.

- Significant volatility in crypto-asset markets, the effects of which include potential impacts on deposit flows associated with crypto-asset companies.

- Susceptibility of stablecoins to run risk, creating potential deposit outflows for banking organizations that hold stablecoin reserves.

- Contagion risk within the crypto-asset sector resulting from interconnections among certain crypto-asset participants, including through opaque lending, investing, funding, service, and operational arrangements. These interconnections may also present concentration risks for banking organizations with exposures to the crypto-asset sector.

- Risk management and governance practices in the crypto-asset sector exhibiting a lack of maturity and robustness.

- Heightened risks associated with open, public, and/or decentralized networks, or similar systems, including, but not limited to, the lack of governance mechanisms establishing oversight of the system; the absence of contracts or standards to clearly establish roles, responsibilities, and liabilities; and vulnerabilities related to cyber-attacks, outages, lost or trapped assets, and illicit finance.

It is important that risks related to the crypto-asset sector that cannot be mitigated or controlled do not migrate to the banking system. The agencies are supervising banking organizations that may be exposed to risks stemming from the crypto-asset sector and carefully reviewing any proposals from banking organizations to engage in activities that involve crypto-assets.

Through the agencies' case-by-case approaches to date, the agencies continue to build knowledge, expertise, and understanding of the risks crypto-assets may pose to banking organizations, their customers, and the broader U.S. financial system.

Given the significant risks highlighted by recent failures of several large crypto-asset companies, the agencies continue to take a careful and cautious approach related to current or proposed crypto-asset-related activities and exposures at each banking organization.

To read more:
https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20230103a1.pdf

Addressing the risks in crypto: laying out the options

Matteo Aquilina, Jon Frost and Andreas Schrimpf

Key takeaways

• The recent high-profile failures of FTX and other crypto firms have re-ignited the debate on the appropriate policy response to address the risks in crypto, including through regulation.

• The "shadow financial" functions enabled by crypto markets share many of the vulnerabilities of traditional finance. These risks are exacerbated by specific features of crypto.

• Authorities may consider different – not mutually exclusive – lines of action to tackle the risks in crypto. These include containment or regulation of the crypto sector or an outright ban.

• Central banks and public authorities could also work to make TradFi more attractive. A key option is to encourage sound innovation with central bank digital currencies (CBDCs).

After the failure of several major crypto firms, addressing the risks from crypto markets has become a more pressing policy issue.

Cryptoasset markets have gone through booms and busts before, and so far, the busts have not led to wider contagion threatening financial stability. Yet the scale and prominence of recent failures heighten the urgency of addressing these risks before crypto markets become systemic.

The crypto ecosystem and the "shadow financial" functions it engages in, through centralised financial entities (CeFi) and decentralised finance (DeFi) protocols, share many of the vulnerabilities that are familiar from traditional finance (TradFi).

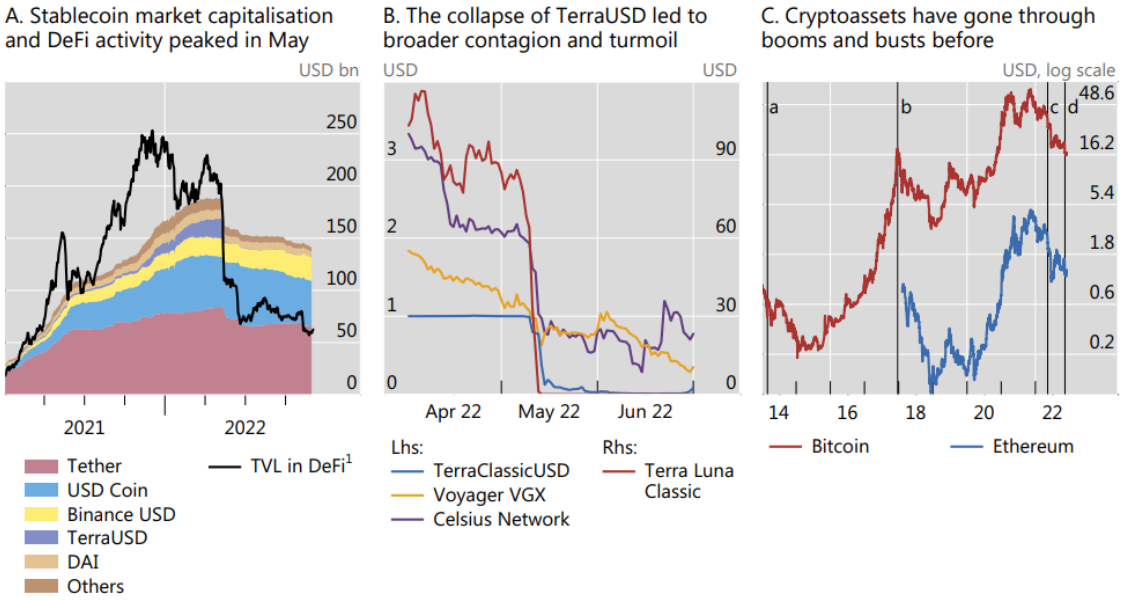
But several factors exacerbate the standard risks. These relate to high leverage, liquidity and maturity mismatches and substantial information asymmetries. Policy responses should consider how to address these sources of risk appropriately, given the borderless nature of crypto.

This bulletin briefly summarises the lessons of the 2022 turmoil. It then outlines three – non-mutually exclusive – lines of action to address the risks in crypto: a ban, containment and regulation, as well as their pros and cons. It also outlines complementary lines of policy action to address inefficiencies in TradFi and curb the demand for crypto.

One key option would be to encourage sound innovation with CBDCs. An online appendix gives a selective overview of ongoing initiatives in crypto regulation.

The recent crypto turmoil: features and lessons

Prices and market capitalisation of crypto assets and the 2022 turmoil — Graph 1



[a] Bankruptcy of Mt Gox on 28 February 2014. [b] Bursting of ICO bubble on 22 December 2017. [c] TerraUSD implosion on 9 May 2022. [d] Bankruptcy of FTX on 11 November 2022.

[1] TVL (total value locked) refers to the total dollar amount of assets that is staked across all DeFi protocols. It does not refer to transaction volumes or the market capitalisation of cryptocurrencies, but rather to the value of reserves that are "locked" into smart contracts. The TVL may vary depending upon the source and is subject to overestimation.

Sources: Bloomberg; CoinGecko; DefiLlama.

After peaking in late 2021, when cryptoasset prices, stablecoin volumes and DeFi activity reached all-time highs (Graph 1, left-hand panel), the crypto ecosystem faced turmoil in 2022.

The decline started early in the year, but problems became acute in May. It was then that a large stablecoin, TerraUSD (UST) – which relied on an algorithm to maintain its peg to the US dollar – collapsed, causing contagion in crypto markets (Graph 1, centre panel).

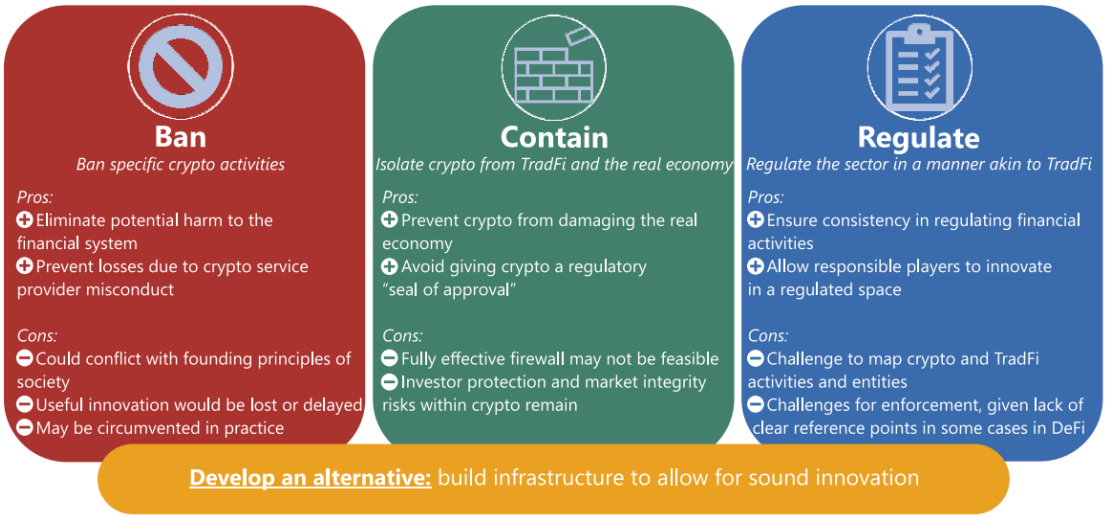
A period of relative calm followed, but crypto markets again saw serious stress in November 2022, when the FTX crypto trading platform declared bankruptcy. In the past, despite repeated turmoil, the crypto ecosystem has survived and prices have often recovered (Graph 1, right-hand panel). There are thus reasons to doubt that crypto will fade away on its own. In particular, a substantial part of the crypto community firmly believes in the ideological pursuit of a decentralised system as an alternative to TradFi.

And in response to recent events, many proponents of crypto claim that decentralisation and the underlying crypto technology are the solution rather than the problem.

They argue that while CeFi entities like FTX were at the epicentre of the stress, DeFi protocols and underlying blockchains continued to function, concluding that only "true" DeFi can be resilient.1

To read more: https://www.bis.org/publ/bisbull66.pdf

Options for addressing the risks in crypto: pros and cons — Graph 2



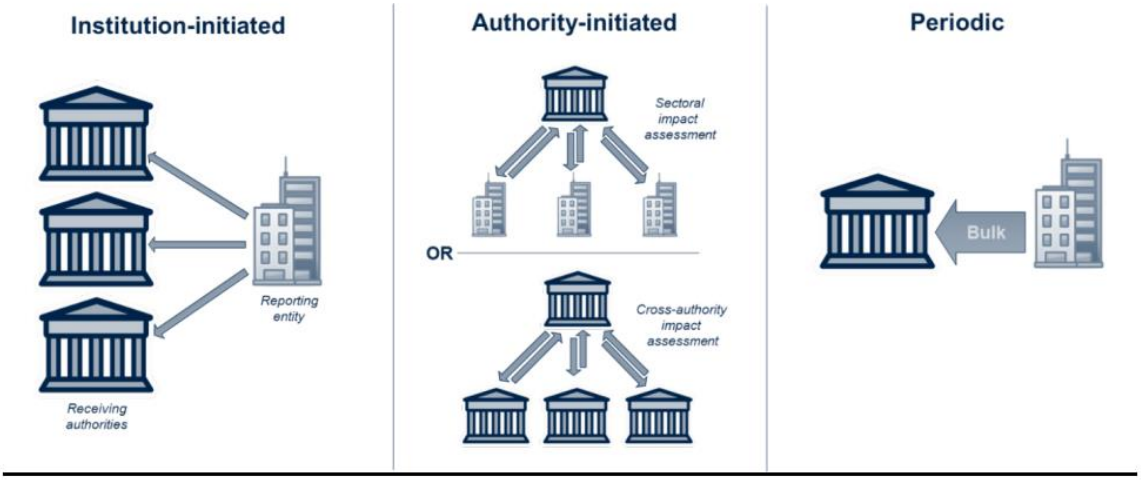
Public responses to consultation on achieving greater convergence in cyber incident reporting

On 17 October 2022, the FSB published Achieving Greater Convergence in Cyber Incident Reporting – Consultative document. You may visit: https://www.fsb.org/2022/10/achieving-greater-convergence-in-cyber-incident-reporting-consultative-document/

Achieving Greater Convergence in Cyber Incident Reporting

Consultative Document

Illustration of reporting types **Figure 6**



Interested parties were invited to provide written comments by 31 December 2022. The public comments received are available below.

The FSB thanks those who took the time and effort to express their views. The FSB expects to publish the final report in April 2023.

We have very interesting responses from:

- Banking Association of South Africa
- EBA Clearing
- European Banking Federation
- Financial Services Sector Coordinating Council
- German Banking Industry Committee
- Global Financial Markets Association
- Global Legal Entity Identifier Foundation
- Google Cloud
- Institute of International Finance
- Insurance Europe
- Intesa Sanpaolo
- NASDAQ
- SWIFT
- Swiss Insurance Association
- UK Finance
- Unipol
- World Council
- World Federation of Exchanges

Swift

Confidentiality: Public
Date: 30 December 2022

Page: 1 of 3

FSB Consultative Document on Achieving Greater Convergence in Cyber Incident Reporting -
Comments from Swift

To read more:
https://www.fsb.org/2023/01/public-responses-to-consultation-on-achieving-greater-convergence-in-cyber-incident-reporting/

NIST Risk Management Framework Aims to Improve Trustworthiness of Artificial Intelligence

New guidance seeks to cultivate trust in AI technologies and promote AI innovation while mitigating risk.

NIST
National Institute of Standards and Technology
U.S. Department of Commerce

The U.S. Department of Commerce's National Institute of Standards and Technology (NIST) has released its Artificial Intelligence Risk Management Framework (AI RMF 1.0), a guidance document for voluntary use by organizations designing, developing, deploying or using AI systems to help manage the many risks of AI technologies.

> The AI RMF refers to an *AI system* as an engineered or machine-based system that can, for a given set of objectives, generate outputs such as predictions, recommendations, or decisions influencing real or virtual environments. AI systems are designed to operate with varying levels of autonomy (Adapted from: OECD Recommendation on AI:2019; ISO/IEC 22989:2022).

The AI RMF follows a direction from Congress for NIST to develop the framework and was produced in close collaboration with the private and public sectors. It is intended to adapt to the AI landscape as technologies continue to develop, and to be used by organizations in varying degrees and capacities so that society can benefit from AI technologies while also being protected from its potential harms.

"This voluntary framework will help develop and deploy AI technologies in ways that enable the United States, other nations and organizations to enhance AI trustworthiness while managing risks based on our democratic values," said Deputy Commerce Secretary Don Graves. "It should accelerate AI innovation and growth while advancing — rather than restricting or damaging — civil rights, civil liberties and equity for all."

Compared with traditional software, AI poses a number of different risks. AI systems are trained on data that can change over time, sometimes significantly and unexpectedly, affecting the systems in ways that can be difficult to understand.

These systems are also "socio-technical" in nature, meaning they are influenced by societal dynamics and human behavior. AI risks can emerge from the complex interplay of these technical and societal factors, affecting people's lives in situations ranging from their experiences with online chatbots to the results of job and loan applications.

The framework equips organizations to think about AI and risk differently. It promotes a change in institutional culture, encouraging organizations to approach AI with a new perspective — including how to think about, communicate, measure and monitor AI risks and its potential positive and negative impacts.

The AI RMF provides a flexible, structured and measurable process that will enable organizations to address AI risks. Following this process for managing AI risks can maximize the benefits of AI technologies while reducing the likelihood of negative impacts to individuals, groups, communities, organizations and society.

The framework is part of NIST's larger effort to cultivate trust in AI technologies — necessary if the technology is to be accepted widely by society, according to Under Secretary for Standards and Technology and NIST Director Laurie E. Locascio.

"The AI Risk Management Framework can help companies and other organizations in any sector and any size to jump-start or enhance their AI risk management approaches," Locascio said. "It offers a new way to integrate responsible practices and actionable guidance to operationalize trustworthy and responsible AI. We expect the AI RMF to help drive development of best practices and standards."

The AI RMF is divided into two parts. The first part discusses how organizations can frame the risks related to AI and outlines the characteristics of trustworthy AI systems. The second part, the core of the framework, describes four specific functions — govern, map, measure and

manage — to help organizations address the risks of AI systems in practice. These functions can be applied in context-specific use cases and at any stages of the AI life cycle.

Working closely with the private and public sectors, NIST has been developing the AI RMF for 18 months. The document reflects about 400 sets of formal comments NIST received from more than 240 different organizations on draft versions of the framework. NIST today released statements from some of the organizations that have already committed to use or promote the framework.

The agency also today released a companion voluntary AI RMF Playbook, which suggests ways to navigate and use the framework.

NIST plans to work with the AI community to update the framework periodically and welcomes suggestions for additions and improvements to the playbook at any time. Comments received by the end of February 2023 will be included in an updated version of the playbook to be released in spring 2023.

To read more:
https://www.nist.gov/news-events/news/2023/01/nist-risk-management-framework-aims-improve-trustworthiness-artificial

https://nvlpubs.nist.gov/nistpubs/ai/NIST.AI.100-1.pdf

Fig. 1. Examples of potential harms related to AI systems. Trustworthy AI systems and their responsible use can mitigate negative risks and contribute to benefits for people, organizations, and ecosystems.

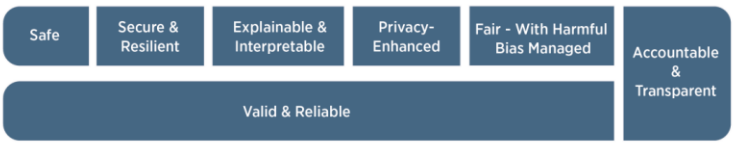


Fig. 4. Characteristics of trustworthy AI systems. Valid & Reliable is a necessary condition of trustworthiness and is shown as the base for other trustworthiness characteristics. Accountable & Transparent is shown as a vertical box because it relates to all other characteristics.

New challenges in a changing world

Christine Lagarde, President of the European Central Bank, at the Deutsche Börse Annual Reception, Eschborn.

Introduction

It is a pleasure to speak with you here in Eschborn, marking the start of the New Year. A new beginning often brings with it new challenges, but it also presents us with plenty of opportunities.

And today I would like to touch on both. Looking at today's global economy, I am reminded of the playwright and poet Bertolt Brecht, who once observed: "Because things are the way they are, things will not stay the way they are."

The global economy finds itself at a crucial turning point. Last year, we began to see the emergence of a "new global map" of economic relationships – one in which geopolitics is increasingly influencing the global economy.

And that in turn has important implications for Europe, which will define the year ahead.

A changing world

This map is defined by three interrelated factors: shocks, supply, and security.

First, with support for an open global trading order on the wane, we are facing new types of shocks to the global economy.

For the past few decades, open trade has supported global growth by allowing countries to "rotate" demand during slumps.

But now it could become a source of volatility. That is because the rise of international free trade – and the stability that comes with it – has historically depended on the backing of a global hegemon.
This was evident during the British Empire in the 19 th century, as it was with American support in the wake of the Cold War.

However, major economies – led by the United States and China – are now increasingly using trade to limit the ambitions of geopolitical rivals.

That could fragment world trade with potentially huge costs. The IMF estimates that severe trade fragmentation may cost global output roughly 7% in the long term – an amount similar to the annual output of Japan and Germany combined.

These geopolitical winds are reshaping the second feature of this new map: supply. We are seeing strategic considerations becoming increasingly important in where suppliers are located.

The US Inflation Reduction Act, for example, is deliberately aimed at "reshoring" production and reducing the country's reliance on strategic imports like batteries.

China is also seeking to reduce its own dependence on the rest of the world. And some surveys suggest that even firms in "non-strategic" sectors are increasingly likely to regionalise their supply chains.

This in turn is leading to the third key feature: the growing importance of security. With the security of supply for critical inputs no longer guaranteed, we are likely to see a new "scramble for resources".

To read more:
https://www.ecb.europa.eu/press/key/date/2023/html/ecb.sp230123_1~2d9786eedf.en.html

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