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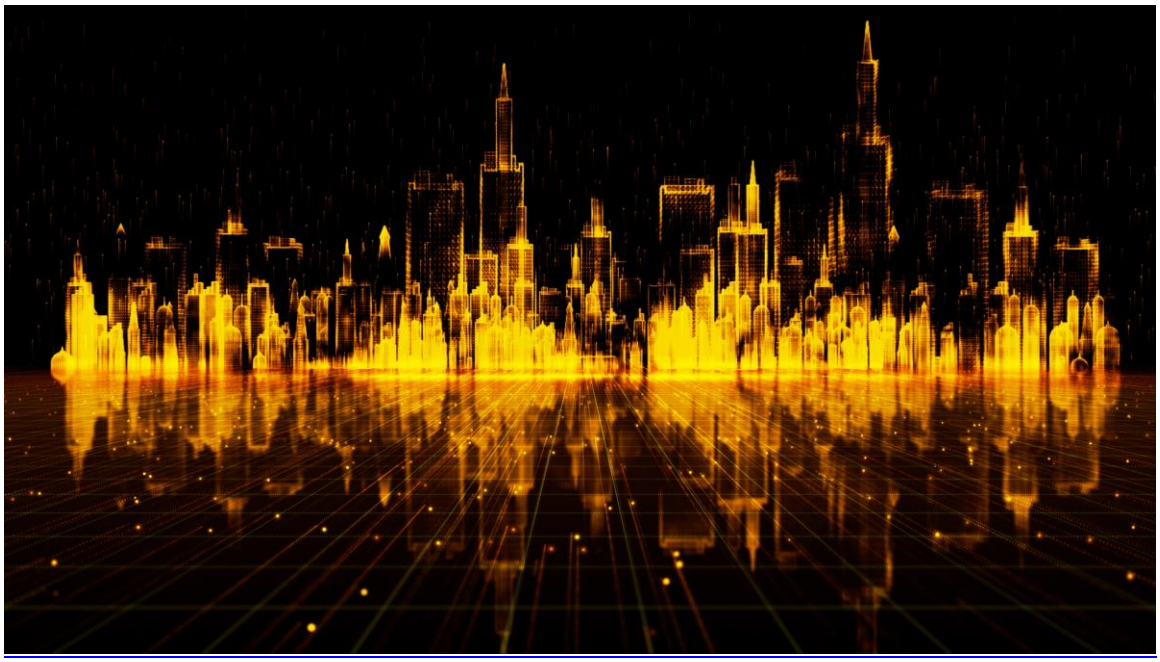


Basel iii News, May 2021

Dear members and friends,

We will start with a very interesting paper from the Committee on the Global Financial System (CGFS Papers, No 66).

Changing patterns of capital flows

Executive summary

The decade following the Great Financial Crisis (GFC) of 2007–09 saw significant changes in the patterns of capital flows, especially in their composition.

These changes reoriented rather than reduced concerns about the potentially adverse impacts of exceptionally large or volatile capital flows. In particular, extreme swings in non-resident inflows still pose a significant risk to macroeconomic and financial stability.

This risk is particularly high for emerging market economies (EMEs), which tend to be more dependent on foreign capital and whose local financial systems are less resilient to shocks.

The challenges posed by large swings in capital flows were highlighted again in the early stages of the Covid-19 crisis, when portfolio flows to EMEs reversed with unprecedented speed and magnitude.

The crisis demonstrated the effectiveness of policy tools in managing the risks associated with extreme shifts in capital flows, but it also served as a reminder that both the toolkit and the framework for its application are still works in progress.

Whereas the Committee on the Global Financial System's (CGFS) previous report on capital flows to EMEs, published in 2009, did not come to a definitive conclusion regarding the net benefits of capital account liberalisation, empirical evidence based on the richer data available today highlights these benefits more clearly.

Capital inflows can have significant positive effects on real economic outcomes and financial development. However, the risks are also clearer, especially the adverse effects of sudden stops in capital inflows.

These risks can be significant, and they are shaped by three sets of factors.

First, they depend on the characteristics that "pull" capital flows towards recipient countries.

Second, they depend on exogenous conditions that "push" capital flows to foreign markets.

Third, they depend on the "pipes" through which capital is channelled, such as different types of financial intermediaries and the rules and practices they follow.

Overall, there is a higher risk that resources will be misallocated when capital flows are driven by global financial conditions or channelled through a domestic financial system beset with financial frictions.

The CGFS's 2009 report concluded that, at that time, a large number of EMEs already met the macroeconomic and financial system preconditions for fully realising the benefits of international capital mobility.

This has since proved to be true. Improvements in EMEs' macroeconomic fundamentals and institutional frameworks have made investors more selective when assessing opportunities in EMEs.

These improvements addressed structural weaknesses, leading investors to shift their focus towards cyclical factors such as economic growth.

Supported by improved fundamentals, capital flows to EMEs have, on average, held up better than those to advanced economies (AEs) in the years since the GFC.

Inflows to EMEs fluctuated around their pre-GFC levels, whereas flows to AEs remained far below their pre-GFC levels. That said, inflows to EMEs remained low in comparison with the size of their economies.

China stood out as one of the few EMEs to see a substantial increase in inflows after the GFC. Even though EMEs have continued to catch up to AEs in terms of the development of their financial systems and policy frameworks, these structural improvements have not insulated them from sudden stops.

The frequency of sudden stops in capital inflows to EMEs has not significantly declined since the GFC.

Importantly, however, the improved resilience of EMEs has reduced the severity of the disruptions these sudden stops cause.

For example, during the Covid-19 crisis, in contrast to previous periods of global stress, many EMEs had enough policy leeway to implement countercyclical policies to smooth the adjustment to the shock.

Sudden stops are typically triggered by exogenous global shocks.

Tightened monetary policy in major AEs stands out as a potential trigger, as seen during the 2013 “taper tantrum”.

Commodity price fluctuations played a role in the sudden stop episodes of 2015. Shifts in international investors’ risk appetite are another possible trigger, as seen during the Covid-19 crisis.

In general, global factors have played a significant role in driving capital inflows to EMEs.

Against the backdrop of a prolonged period of low interest rates, there has been abundant global liquidity since the GFC, fuelling international investors’ pursuit of yield.

Shifts in risk appetite have also had an important influence on the ebb and flow of capital.

Furthermore, due to China’s growing weight in global activity, economic and policy developments in that country have increasingly shaped capital flow patterns, as demonstrated by the financial market fluctuations that followed the devaluation of the renminbi in 2015.

Since the GFC, the pipes that channel capital flows to EMEs have changed significantly. An increasing share of foreign capital has been channelled through investment funds and other portfolio investors.

Indeed, in many countries, portfolio investors have surpassed banks as the largest source of foreign credit.

Other changes in these pipes include the international expansion of EME-based banks and investors, which has also broadened the role of public sector investors in international capital markets.

Foreign direct investment (FDI), which has historically been the most stable and beneficial type of capital inflow, has also been more affected by financial and tax-related strategies than it had been in the past.

These changes have altered the risks associated with capital inflows to EMEs.

On the one hand, they helped diversify the investor base and develop local financial markets.

This in turn enabled governments to borrow in their own currency rather than in foreign ones, thus reducing the currency mismatches that had exacerbated earlier crises in EMEs.

On the other hand, the rising importance of portfolio investors exposed EMEs to new risks, or rather, “old risks in new clothes”.

Passive investment strategies and other practices in the asset management industry can give rise to herd behaviour and contagion, such as when changes to a bond or equity index trigger a rebalancing by the portfolio investors tracking the index.

Also, unhedged investments can amplify feedback loops between exchange rates and asset prices, potentially resulting in destabilising dynamics.

Other players, like rating agencies, have become an integral part of the global financial infrastructure, presenting their own new risks and benefits.

More generally, the Covid-19 crisis increased attention on the potential systemic risks associated with nonbank financial intermediation and how to enhance its resilience.

The CGFS’s 2009 report concluded that the optimal response to large and volatile capital flows is a combination of macroeconomic and structural policies.

It also concluded that there is no “one size fits all” regarding precisely how these polices are best combined – the best combination depends on the country and the context.

This report reaffirms these conclusions and expands upon them to highlight that, even for EMEs with strong structural policies and sound fundamentals, there are circumstances in which additional policy tools, particularly macroprudential measures, occasional foreign exchange intervention and liquidity provision mechanisms, can help mitigate capital flow-related risks.

Furthermore, the Covid-19 crisis underscored the critical role of international cooperation.

The pipes that channel capital are interconnected and operate on a global scale.

Therefore, policy actions that affect these pipes and the flows they channel have global implications.

This highlights the importance of international dialogue about potential spillovers.

It also confirms the need for a strong global financial safety net composed of a mix of tools suited to different shocks, including tools for alleviating short-term liquidity pressure as well as others designed to ease medium-term adjustment.

It also highlights the need for clear international guidance on the appropriate use of various policy tools in managing extreme shifts in capital flows, taking into account their spillovers and other multilateral consequences.

The first chapter of this report outlines trends in capital flows since the GFC, especially their composition and volatility.

The second chapter examines the drivers of capital flows, distinguishing between what drives capital flows in normal times and what drives them during periods of extreme volatility.

The third chapter analyses the benefits and risks of capital flows.

The final chapter examines policy tools and lessons for managing risks, drawing on central banks' views of the effectiveness and potential side effects of various tools.

To read more (98 pages) you may visit:
https://www.bis.org/publ/cgfs66.pdf

Deputy Comptroller for Market Risk Policy Testifies on LIBOR Transition

Office of the
Comptroller of the Currency

Deputy Comptroller for Market Risk Policy Kevin Walsh testified during a hearing before the U.S. House Financial Services Subcommittee on Investor Protection, Entrepreneurship and Capital Markets regarding the upcoming cessation of the London Interbank Offered Rates (LIBOR).

Oral Statement of Kevin P. Walsh Deputy Comptroller for Market Risk Policy Office of the Comptroller of the Currency Before the Subcommittee on Investor Protection, Entrepreneurship and Capital Markets of the Committee on Financial Services U.S. House of Representatives.

Chairman Sherman, Ranking Member Huizenga, and members of the Subcommittee, thank you for the opportunity to discuss the OCC's work to ensure the large, midsize, and community banks we supervise are prepared for the cessation and replacement of the London Interbank Offered Rates or LIBOR.

I am Kevin Walsh, Deputy Comptroller for Market Risk Policy. I am the OCC's ex-officio member of the Alternative Reference Rate Committee, oversee the agency's representation on other committees associated with LIBOR's cessation, and oversee the development and interpretation of policy and guidance related to market risk facing the federal banking system.

The OCC has worked closely with the institutions we supervise to ensure their preparedness since 2018.

To avoid the risk of market disruptions, prolonged litigation, and adverse financial impacts, the OCC has stressed to banks we supervise the importance of adequate transition planning and successfully executing those plans before LIBOR ceases to be reported.

The OCC's mission is to ensure that the institutions we charter and supervise operate in a safe and sound manner and treat all customers fairly. Rather than endorse any specific replacement rate—including the Secured Overnight Financing Rate or SOFR—we want to ensure that banks have the flexibility to determine LIBOR's successor rate or rates as may be most

appropriate for the continued operation of their business model and risk appetite and the function that rate supports, in a safe and sound manner.

Starting in 2018, as part of our ongoing outreach sessions with bank CEOs, CFOs, Chief Risk Officers, and Bank Directors, we included discussions of LIBOR's cessation and encouraged them to consider their exposures, risk tolerances, and mitigation plans.

We first mentioned the need for LIBOR transition plans in our Semiannual Risk Perspective that year.

Since then, we have published several bulletins and guidance documents that set forth our expectations for bank transition activities.

In November 2020, the OCC published a joint letter with the Federal Reserve and the FDIC that reiterated that a bank may use any reference rate it determines to be appropriate for its business model and customer needs.

That month, the OCC and other banking regulators clarified expectations that banks must stop creating new LIBOR exposures by the end of 2021, with few exceptions.

To read more:
https://www.occ.treas.gov/news-issuances/congressional-testimony/2021/ct-occ-2021-46-oral.pdf

https://www.occ.treas.gov/news-issuances/congressional-testimony/2021/ct-occ-2021-46-written.pdf

The End of LIBOR: Transitioning to an Alternative Interest Rate Calculation for Mortgages, Student Loans, Business Borrowing, and Other Financial Products

Mark Van Der Weide, General Counsel, before the Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets, Committee on Financial Services, U.S. House of Representatives, Washington, D.C.

Chairman Sherman, Ranking Member Huizenga, and members of the subcommittee, thank you for the opportunity to appear today.

My testimony will discuss the importance of ensuring a smooth, transparent, and fair transition away from LIBOR (formerly known as the London interbank offered rate) to more durable replacement rates, as well as some of the challenges posed by this transition. Before I delve into those issues, however, it may be helpful to review how LIBOR is used and why it will be discontinued.

LIBOR measures the average interest rate at which large banks can borrow in wholesale funding markets for different periods of time, ranging from overnight to one month, three months, and beyond.

LIBOR is an unsecured rate that measures interest rates for borrowings that are made without collateral.

Over the past few decades, LIBOR became a benchmark rate used to set interest rates for commercial loans, mortgages, derivatives, and many other products. In total, U.S. dollar LIBOR is used in more than $200 trillion of financial contracts worldwide.

By now the flaws of LIBOR are well documented. One of the fundamental problems is that LIBOR purported to be a representation of the actual funding costs of large banks in the London interbank market, but the evolution of that market over the years meant that, for many tenors, banks were estimating the likely cost of such funding rather than reporting the actual cost.

This increasing element of subjectivity and discretion, coupled with the mechanisms that had been adopted to aggregate various banks' inputs into the determination of LIBOR, made the rate vulnerable to collusion and manipulation.

Particularly after the global financial crisis of 2008, as banks sharply reduced their reliance on wholesale unsecured funding, there were few actual funding transactions on which to base a rate for many tenors of LIBOR.

While banks are, of course, not required to price their credit as a direct function of their cost of funding or on any amalgam of actual transaction data, the LIBOR mechanism—by purporting to be a measure of such costs even though there were not sufficient transactions to justify that perception—had become potentially misleading to many of those relying on it for credit pricing and other decisions.

Over time, with a large number of contracts referencing a thinly traded rate, the incentive to manipulate LIBOR grew and actual manipulation of LIBOR abounded.

Following the exposure of these weaknesses, and the imposition of material legal penalties on a number of banks and individuals that engaged in misconduct related to the setting of LIBOR rates, the great majority of the banks that had provided submissions to be used in the setting of LIBOR (the so-called panel banks) determined that they would not continue participating in the process.

This was not the result of a regulatory or legal requirement to end LIBOR. It was a private sector decision to stop providing what had always been a completely voluntary service, given the firms' assessment of the costs and benefits of doing so.

While regulators are appropriately focusing on whether financial firms have prepared themselves for the date when the panel banks have said they will no longer provide LIBOR, the decision to end LIBOR itself has not been a governmental decision, but a private sector development.

Last month, LIBOR's regulator in the United Kingdom announced that the one-week and two-month U.S. dollar LIBOR term rates will cease to be published at the end of 2021, while overnight and other LIBOR term rates will cease to be published on a representative basis in mid-2023.

This definitive announcement about the end of panel-based LIBOR underscores the importance of transitioning away from this moribund benchmark rate.

Efforts to Transition Away from LIBOR

Market participants, regulatory agencies, consumer groups, and other stakeholders have put in a great deal of work to prepare for life after LIBOR. Beginning in 2013, the domestic Financial Stability Oversight Council and

the international Financial Stability Board expressed concern that the decline in unsecured short-term funding by banks could pose serious structural risks for unsecured benchmarks like LIBOR.

To mitigate these risks and promote a smooth transition away from LIBOR, the Federal Reserve convened the Alternative Reference Rates Committee (ARRC) in November 2014.

Recognizing that the private sector must drive this transition, the ARRC's voting members are private-sector firms. The Federal Reserve and the other agencies testifying today are ex-officio members of the ARRC.

The ARRC set about to identify alternative reference rates that were rooted in transactions from an active and robust underlying market.

In June 2017, the ARRC identified the Secured Overnight Financing Rate (SOFR) as its recommended alternative to U.S. dollar LIBOR. SOFR is a broad measure of the cost of borrowing cash overnight, collateralized by Treasury securities.

The Federal Reserve Bank of New York publishes SOFR each morning. Unlike LIBOR, SOFR is based on a market with a high volume of underlying transactions—regularly around $1 trillion daily.

The ARRC developed a multi-step plan in October 2017 to facilitate the transition from LIBOR to SOFR.

The Federal Reserve and other agencies also sponsored a series of workshops with lenders and borrowers that focused on the use of credit-sensitive alternative reference rates for loans.

Relatedly, the Federal Reserve, Office of the Comptroller of the Currency (OCC), and Federal Deposit Insurance Corporation (FDIC) issued a statement last year to emphasize that a bank may use any reference rate for its loans that the bank determines to be appropriate for its funding model and customer needs.

The statement also noted, however, that a bank's loan contracts should include robust fallback language that provides for a clearly defined alternative reference rate to be used if the initial reference rate is discontinued.

Supervisory Efforts

Beginning in 2018, Federal Reserve staff began outreach to supervised institutions and examiners to raise awareness about, and encourage preparation for, the transition away from LIBOR.

In 2019, we established a LIBOR Transition Working Group to coordinate monitoring of the transition and develop supervisory plans to assess banks' preparation efforts.

In November 2020, the Federal Reserve, OCC, and FDIC sent a letter to the banking organizations that we regulate, noting that there are safety and soundness risks associated with the continued use of U.S. dollar LIBOR in new transactions after 2021.

Accordingly, we have encouraged supervised entities to stop using LIBOR in new contracts as soon as practicable and, in any event, by the end of this year.

Federal Reserve Vice Chair for Supervision Randal Quarles emphasized in a recent speech that banking firms should be aware of the intense supervisory focus the Federal Reserve is placing on the LIBOR transition, and especially on plans to end issuance of new LIBOR contracts by year-end.

Legacy Contracts

A key question is whether existing LIBOR-based contracts (legacy contracts) can seamlessly transition to alternative reference rates when LIBOR ends. The ARRC recently estimated that 35 percent of legacy contracts will not mature before mid-2023.

Some of these legacy contracts have workable fallback language to address the end of LIBOR, but others do not. For example, most business loans have workable fallback language—by their terms, business loans generally fall back to an alternative floating rate, such as the prime rate.

Similarly, most derivatives are governed by a master agreement published by the International Swaps and Derivatives Association (ISDA), and ISDA has published a "protocol" that allows derivative counterparties to amend their master agreements, on a multilateral basis, so that their derivative contracts fall back to a floating SOFR-based rate for counterparties that adhere to the protocol.

Conversely, many floating-rate notes and securitizations have problematic fallback language—generally, these contracts convert to fixed-rate instruments at the last published value of LIBOR.

Moreover, the rate terms in floating-rate notes and securitizations can typically be changed only with the unanimous consent of all noteholders, which typically would be difficult to secure.

The end of LIBOR may result in significant litigation. For example, if a legacy contract converts to a fixed rate when LIBOR ends, a party

disadvantaged by that conversion might request that a court reform the contract by substituting an alternative floating rate for LIBOR.

Parties also might request that a court reform or void a legacy contract that lacks any fallback language if the parties cannot agree bilaterally on a successor rate.

Similarly, in instances where a legacy contract allows a person to select a replacement rate when LIBOR ends, a party disadvantaged by the replacement rate might argue that the manner in which another person—for example, a bond trustee—selected the replacement rate violates the implied covenant of good faith and fair dealing.

Chair Powell and Vice Chair Quarles have publicly stated their support for federal legislation to mitigate risks related to legacy contracts. Federal legislation would establish a clear and uniform framework, on a nationwide basis, for replacing LIBOR in legacy contracts that do not provide for an appropriate fallback rate.

Federal legislation should be targeted narrowly to address legacy contracts that have no fallback language, that have fallback language referring to LIBOR or to a poll of banks, or that convert to fixed-rate instruments.

Federal legislation should not affect legacy contracts with fallbacks to another floating rate, nor should federal legislation dictate that market participants must use any particular benchmark rate in future contracts. Finally, to avoid conflict of laws problems, federal legislation should pre-empt any outstanding state legislation on legacy LIBOR contracts.

Thank you. I look forward to your questions on this important matter.

Central banks and inequality

Agustín Carstens, General Manager of the BIS, at the Markus' Academy, Princeton University's Bendheim Center for Finance, Basel.

Introduction

Thanks very much for inviting me to give this lecture. It is a pleasure to be here virtually today and share with you my thoughts on how central banks can best contribute to a more equal society.

Central banks are concerned about inequality. As public institutions, their end goal is to ensure economic conditions that support the well-being of citizens.

I will argue that, over the long run, inequality is not a monetary phenomenon, though central banks' actions can have an impact on the distribution of wealth and income over shorter horizons.

Prolonged periods of high inflation and recessions can hurt the economy and disproportionately hit the most disadvantaged.

Therefore, the best contribution monetary policy can make to an equitable society is to try to keep the economy on an even keel by fulfilling its mandate.

Governments can reduce inequality through more direct fiscal and structural policies.

In this lecture, I will review the recent trends of rising inequality and ask why central banks have engaged in this debate only after the Great Financial Crisis (GFC) – more than two decades after the trend increase in inequality picked up.

I will argue that both the actions needed to achieve the mandated objectives, and the interaction between monetary policy and inequality, have become increasingly complex over time.

This is due to a change in the nature of the business cycle.
Two characterising features of this change – particularly since the GFC – are low and less responsive inflation, and financial factors playing a more prominent role in amplifying economic fluctuations.

The focus of my lecture will be on monetary policy in its macro stabilisation role.

The nature and precise interpretation of central banks' mandate in this regard has evolved historically.

These days it is primarily interpreted as limiting business cycle fluctuations – measured in terms of output and employment – and delivering low and stable inflation.

And low and stable inflation is rightly seen as a necessary condition to maximise output and employment sustainably over time.

But there is another necessary condition for macroeconomic stability: financial stability.

While most central banks do not have financial stability as a separate objective in their monetary policy mandates, changes in the business cycle have brought it to the fore.

In a narrow sense, creating conditions for financial stability means mitigating the likelihood and severity of events such as banking and financial crises and the large output losses they bring about.

But in a broader sense financial stability relates to financial factors as amplifiers of business cycle fluctuations and, as such, forces that can stand in the way of achieving monetary policy objectives.

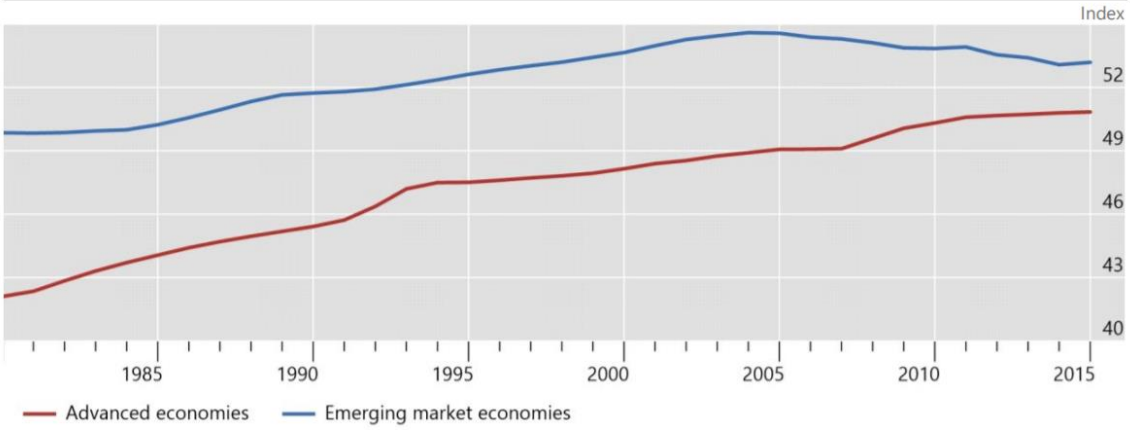
For this reason, I will include financial stability under the broader objective of stabilising economic activity

Inequality has been on the rise, as recognised by central banks

Distributional issues have gained prominence in the public debate over the past decades, as the two main dimensions of economic inequality – income and wealth – have been on an upward trend.

Graph 1 displays a popular measure of income dispersion among the population – the pre-tax and transfers Gini coefficient – and shows that it has been rising since the 1980s.

Gini index based on pre-tax, pre-transfer income — Graph 1



Defined as the amount of money coming into the household pre-tax, excluding government cash or near-cash benefits. The series are weighted averages of AEs and EMEs calculated based on GDP (PPP) with fixed 1980 weights. AEs = CA, DE, FR, GB, IT, JP and US; EMEs = BR, CN, IN and ZA.

Sources: Standardized World Income Inequality Database (SWIID); national data; BIS calculations.

A similar – although less steep – trend emerges when looking at measures of wealth inequality.

While income inequality has remained consistently higher in emerging market economies (EMEs) than in advanced economies (AEs) throughout the period, it has seen a much steeper increase in AEs.

The increase has not only been more modest in EMEs, it has even partially reversed over the last 10 years.

A concrete example to show the recent rise in income inequality is the case of the United States, where the share of income held by the top 1% of the population grew from 11% in 1986 to 19% in 2019.

Importantly, the trend in inequality is largely the outcome of long-run structural forces, widely explored and documented in the literature.

Among those, technological change, globalisation and institutional changes have played a major role during the past decades.

These forces are largely independent of and insensitive to monetary policy, so the trends to which they contribute are best corrected by public policies, particularly fiscal policies.

To read more: https://www.bis.org/speeches/sp210506.pdf

Commitment to sustainable reporting culture is key to Bangladesh banks' transparency and efficiency

Additional Managing Director at Standard Bank Limited (a Shari'ah Based Islami Bank in Bangladesh)

Sustainability reporting is mandatory for banking institutions in Bangladesh considering environmental and socio-economic and governance issues

- Banks' commitment to a healthy sustainable disclosure practice is good for everyone

- Bangladeshi banks are bound by policies to incorporate 'green banking' initiatives in their agenda

- Majority of banks do not practice sustainability reporting

A sustainable world economy is essential for society, and a bank, as responsible corporate citizen, needs to devise a long-term strategy towards sustainable financing activities through various effective initiatives. The question is, "How can it be started?"

To read more:
https://www.theasianbanker.com/updates-and-articles/commitment-to-sustainable-reporting-culture-is-key-to-bangladesh-banks-transparency-and-efficiency

FinTech, BigTech and cryptos – will new technology render banks obsolete?

Ida Wolden Bache, Deputy Governor of Norges Bank (Central Bank of Norway), Oslo

Introduction

"No state can endure without a well functioning monetary system." The quote comes from the Constitutional Assembly at Eidsvoll in 1814. At that time, it was imperative to restore the monetary system and establish our own national currency.

Two years later, Norway saw the birth of its first bank – Norges Bank. For many years, it was the country's only bank. Today, more than 200 years later, Norges Bank is the bankers' bank and forms the core of a network of small and large banks spread throughout the country.

But the number of physical premises is steadily declining, and our national currency – the krone – is predominantly a number on a screen rather than a physical handheld object.

And if things develop as some might believe, tomorrow's financial system will not be made up of banks, central banks and national currencies – but of electronic signals that transfer cryptocurrencies – from one digital wallet to another. To quote a well know Norwegian businessman: "The direction is clear: finance will be disrupted as surely as fossil fuels will be. The question is not if, but when."

I think there is little chance that cryptocurrencies will make banks and Norwegian kroner obsolete anytime soon, but the financial system will change.

Innovative technology is paving the way for new and improved financial services, while competition among financial service providers is intensifying. In a digital world, location and national borders become less important.

The banking system in Norway is at the forefront of technology. Cash usage is low, and almost four in five person-to-person payments are made using Vipps mobile payment services.

Norway ranks at the top in Europe in terms of use of internet banking, and robots are performing tasks such as customer contact and processing of loan applications.

The largest Norwegian banks have the lowest cost-to-income ratios in the EEA. Payment services costs are also low in Norway compared with other countries.

Even though Norwegian banks are well positioned to meet growing competition, they are not sheltered, nor should they be. Increased competition for financial services is an intended development.

Combined with digitalisation, this engenders better and cheaper banking services for customers, giving more people access to financial services. But new technology and increased competition can also disrupt the very key role banks play in the financial system.

The changes we are observing raise big questions: Are we headed towards a monetary system that is fundamentally different from the one we have today? Will tech giants and cryptocurrrencies outcompete banks and national currencies in a few years?

To shed light on these questions I will look at what actually characterises the role of banks, how competition from new participants might influence the financial system and finally the implications of the changes underway for Norges Bank's role and responsibilities.

The role of banks in the financial system

The financial system should deliver a number of very basic services.

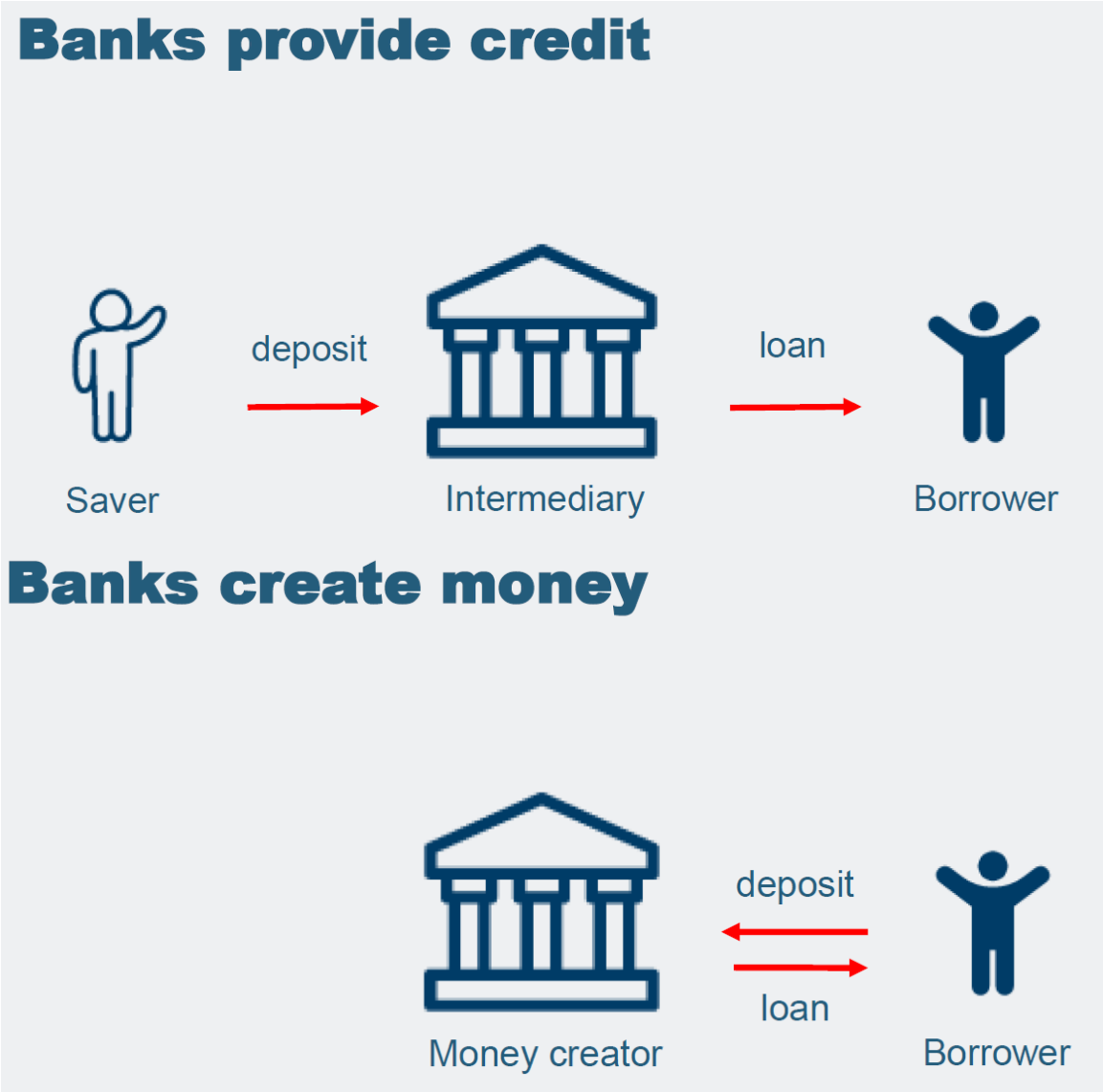
We want to be able to borrow in order to study or buy a home today, while paying out of future income. We also want to be able to borrow long-term to finance investment projects with high expected returns.

In addition, we need a means of payment that provides fast, safe and reasonably priced settlement services for both domestic and cross-border transactions.

The means of payment should also be a savings vehicle. A pre-condition is that we have confidence in the current and future value of money.
In today's system, banks have a key role in providing these services. They offer credit, savings products and payment services.

Banks are often described as agents that provide credit by taking deposits from savers and lending part of that money to borrowers. This description

of banks is not entirely wrong, but overlooks an essential component of banking and a function that distinguishes banks from non-financial firms.



The description does not explain where the deposits originate. The deposit placed in one bank can come from another bank. But what if we take banks as a whole? The answer is that banks create deposits when they extend loans to their customers. When a bank grants a loan, money that did not exist before is credited to the customer's account. The bank does not have to find someone who wants to save before it can make a loan. The bank creates its own funding in the act of lending. Banks thereby also create the money we all use. No other financial firm can do that.

Non-bank financial institutions must hold deposits in a bank for them to be able to pay another party.

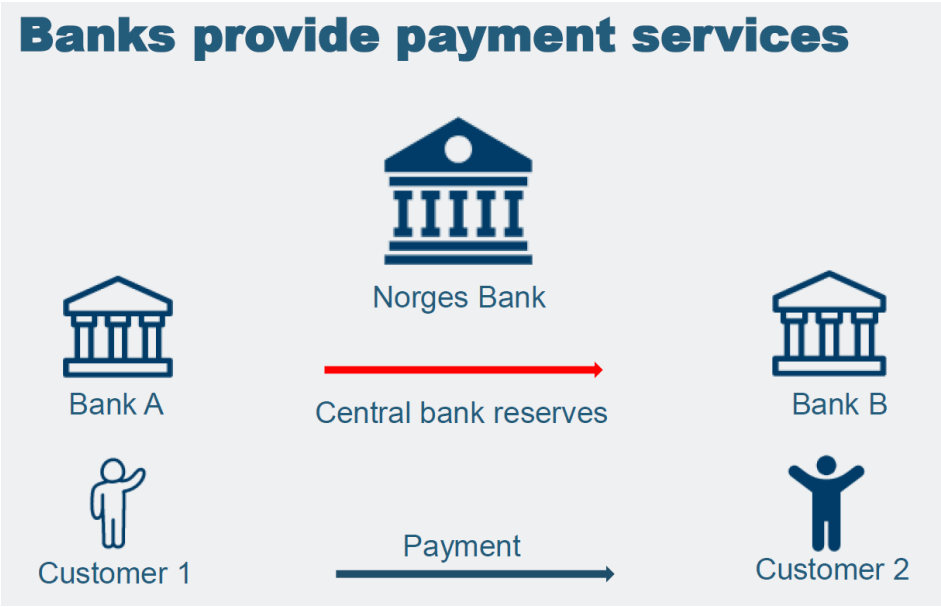
Almost all the money we spend daily is deposit money created by a bank. There is little likelihood that many customers will withdraw large amounts

simultaneously. Banks can therefore create far more deposits than they can pay out at the same time.

But a bank cannot extend loans and create deposits without limitations. First, it must assess the customer's debt-servicing capacity, ie credit risk. Second, the bank must assess the degree of liquidity risk associated with lending long and creating deposits that customers can withdraw at any time. Third, it must comply with statutory rules.

Banks' willingness to assume some degree of liquidity risk is a public good. In its absence, we would have less access to long-term loans and money in the form of bank deposits. On the other hand, too much liquidity risk entails a risk of instability and crises like the one we experienced in 2008. Banking regulation implicitly provides a trade-off between these considerations.

The other main activity of banks is payment services, which are services we use virtually every day. Today, most people in Norway receive money as a bank deposit directly into their account. As long as there are payment solutions that give us cheap and simple access to money, the account is an efficient and safe wallet.



But how is it that bank deposits can become money that we can use as payment? An important pre-condition is that there is an infrastructure to enable deposits to be efficiently transferred between customers and banks.

As the bankers' bank, Norges Bank creates the money banks use to pay each other, so-called central bank reserves, which are the banks' deposits at the central bank.

Transfers of customer deposits between banks can take place without frictions because a corresponding amount of central bank reserves are transferred between banks' own accounts at Norges Bank, where banks have a common and trusted means of payment and settlement system.

This helps ensure that there is no difference between the money created by DNB and money created by Nordea. The money is interchangeable. For us, it is all Norwegian kroner.

As such, banks play a key role in delivering services we want from the financial system, albeit subject to a framework designed by the Norwegian authorities. The banking sector is more strictly regulated than most sectors of the economy. With the right to create money comes obligations.

To read more:
https://www.norges-bank.no/en/news-events/news-publications/Speeches/2021/2021-05-11-bache/

https://www.norges-bank.no/contentassets/679dc7eb81e14644802242571 8cbfb4c/speech_charts_iwb-vartale-11-05-2021.pdf?v=05/11/202108004 7&ft=.pdf

How to improve funding of bank resolution in the banking union: the role of deposit insurance

Fernando Restoy, Chairman, Financial Stability Institute, Bank for International Settlements, at the 2021 Biennial International Association of Deposit Insurers Research Conference "Navigating the New Normal for Financial Stability, Deposit Insurance and Bank Resolution", Basel.

Introduction

It is a pleasure to participate in this event organised by IADI.

This research conference provides a great opportunity to scholars in the field to share, among other contributions, analytical work on the interaction of crisis management frameworks with deposit insurance.

This is a key issue within the ongoing reflection in the European Union on how to improve the current arrangements for bank failure management and, in particular, on how to best adjust the existing funding mechanisms.

It is unlikely that authorities will be able to achieve consensus quickly on what to change and how to do it. But the ongoing discussions already show that an agreement may be emerging on the diagnosis of a few relevant flaws of the current framework

First, at present the banking union lacks an efficient and sufficiently harmonised framework to deal with bank insolvency.

Second, the combination of a common resolution framework with a constellation of heterogeneous insolvency regimes generates inconsistencies that can severely damage authorities' ability to deal with the failure of systemic banks without relying on taxpayers' support.

And third, some banks are too large for their failure and market exit to be managed through conventional insolvency regimes, but still do not qualify, or cannot meet requirements for, resolution under the Bank Recovery and Resolution Directive (BRRD). These banks are what I have referred to elsewhere as the "middle-class".

Some of us have long been suggesting that the above deficiencies could be largely corrected by putting in place harmonised mechanisms to facilitate

transfer transactions – such as the sale of a suitable combination of deposits and assets from the failing entity to an acquirer – for small and medium-sized banks under both resolution and insolvency.

Under the EU resolution framework, such transactions are labelled "sale of business" (SoB). In that regard, a helpful reference – although not a full solution – can be found in the US regime administered by the Federal Deposit Insurance Corporation (FDIC).

Those mechanisms would entail adjustments in the institutional framework at the EU and national levels. However, the most important modifications affect the available funding arrangements for relevant crisis management strategies. Money is, as always, key.

In crisis situations, sufficient funds are required to protect the public interest when resolving banks (ie the continuation of critical functions). In addition, they may be needed to preserve banks' net asset value and therefore to protect the interest of the deposit guarantee scheme (DGS) and other creditors under insolvency.

The amount of funding needed crucially depends on the chosen bank failure management strategy. The market exit of a failed bank – even when its critical functions are preserved through an SoB transaction – typically requires fewer resources than its restoration through recapitalisation.

In what follows, I will review the existing funding mechanism and propose a few concrete modifications that could help address the main drawbacks of the current setup.

The existing funding mechanisms

In principle, there are three different sources of funding for the orderly management of bank failures under resolution or insolvency: public funding, a bank's internal loss-absorbing capacity and industry-funded sources such as a deposit guarantee scheme or resolution fund.

The most direct form of funding is government bailout. That has been, in practice, the most relevant funding source for managing the failure of significant banks to date.

The new resolution framework, however, is built with the objective of avoiding recourse to government funds to maintain the critical functions of failing banks. Yet, as recent experience shows, taxpayer funds are still available to fund banks' exit from the market under national insolvency regimes.

At the other extreme, a core source of funding is banks' own internal resources. Creditor bail-in – ie the writedown or conversion into equity of debt instruments for loss absorption and recapitalisation – could fund the continuation of critical functions by failing banks. This is the cornerstone of the new resolution framework.

In order to make this strategy feasible, banks that may be resolved are typically asked to issue a sufficiently large amount of debt instruments that could be bailed-in in resolution. In the EU, that takes the form of a minimum requirement for own funds and eligible liabilities (MREL).

The current SRB approach to setting MREL aims at ensuring that all banks whose failure may have public interest implications should have a credible resolution strategy that entails no need for external support, from either the government or industry-funded sources, such as a resolution fund or a DGS.

To meet that objective, banks subject to a preferred resolution strategy based on open bank bail-in must satisfy MREL requirements that are consistent with their estimated needs for loss absorption and recapitalisation in resolution, so that the entity can continue to operate immediately after resolution, pending restructuring.

For banks with a credible SoB transaction as a preferred strategy, MREL needs could, in principle, be lower as the bank will cease operating after resolution.

However, given the uncertainty about the availability of a suitable buyer at the point of resolution, the SRB also develops a variant strategy for such banks that is less dependent on third parties and market conditions. In most cases, that is open bank bail-in. The SRB then calibrates MREL at the level needed to implement that variant strategy.

As a consequence, significant banks in the banking union are generally asked, in practice, to satisfy stringent MREL requirements regardless of their preferred strategy. In other words, MREL is effectively calibrated so as to primarily accommodate a restoration strategy.

However, the SRB may need to adjust this approach somewhat as the new Single Resolution Mechanism Regulation (SRMR) explicitly links possible adjustments to MREL requirements to the needs of the preferred resolution strategy.

A third source of funding is the national DGS. Those funds can contribute to supporting transfer transactions in both resolution and insolvency. However, there is a tight limit on that contribution (a financial cap): funds provided by the DGS cannot exceed the net costs for the DGS of paying out

deposits if the bank in question is wound up under the national insolvency procedures.

"Net costs" in this context refers to net of the recoveries the DGS would have made in a liquidation following a payout of insured deposits. In the EU, DGS claims rank senior to other deposits and securities issued by banks (they are "super-preferred"), so expected losses for the DGS in liquidation and, therefore, the available support for a SoB transaction are typically small when not negligible.

Therefore, while a financial cap is a necessary protection for DGS funds that prevents excessive expenditure in a single bank failure, the way in which the cap currently applies makes DGS support for SoB transactions largely irrelevant in practice.

Finally, another source of possible funding for bank failure management in the banking union is the Single Resolution Fund. The SRF is only available for banks meeting the positive public interest assessment required for resolution. Available SRF support is capped at 5% of total liabilities and, more importantly, requires the prior writedown of at least 8% of total liabilities.

Minimum bail-in requirements ensure that the SRF funds are available only when the liabilities that can realistically absorb losses – ie without undermining the effectiveness of the resolution or the resolution objectives – have done so.

The 8% minimum bail-in condition for SRF access is imposed across the board regardless of the failing bank's preferred resolution strategy. It does not therefore accommodate the situation of banks with a large amount of deposits relative to other liabilities that can absorb losses without unintended effects.

Imposing the same minimum bail-in conditions for SRF access by any bank further reinforces the SRB's approach of imposing stringent MREL requirements on all significant banks irrespective of their preferred resolution strategy.

The current framework is therefore internally consistent: restrictions on the use of DGS and SRF funds to facilitate an SoB transaction justifies requiring all banks to satisfy large MREL requirements.

Banks that can meet those conditions may credibly be subject to open bank bail-in (as the preferred or a backup strategy) and may also satisfy the conditions required to obtain SRF support if that is needed. The problem, of course, is that a relatively large subset of banks under the SRB remit run

business models that could not easily cope with the conditions imposed (MREL requirements) for their resolution strategies.

On the basis of the new provisions of the SRMR, the SRB will need to adjust downwards MREL requirements for all banks whose preferred resolution strategy is SoB. However, under current arrangements that adjustment cannot realistically be far reaching.

Without further reforms that would increase the feasibility of SoB for a failing bank, the lack of sufficient loss-absorbing liabilities could severely jeopardise the orderly resolution of that bank. Absent a suitable buyer, the bank might only be able to continue operating and have access to the SRF if sensitive liabilities – such as deposits – were bailed-in.

Therefore, solving the middle-class issue requires a comprehensive approach that could lead to a new internally consistent setup that would be less disruptive than the current one.

That might be achieved by adopting three main reforms:

(i) first, make DGS funding less restrictive by replacing the current super-preference of covered deposits by a general depositor preference rule;

(ii) second, redefine the methodology for calculating MREL requirements for banks with a resolution plan based on SoB transactions to accommodate a higher likelihood of success of that strategy; and

(iii) replace the currently universal 8% minimum bail-in conditions for SRF access by a case by case calibration linked to MREL requirements. Let me review each of those three proposals.

To read more: https://www.bis.org/speeches/sp210511.htm

FBI TLP White Flash Alert: Conti Ransomware Attacks Impact Healthcare and First Responder Networks

Summary

The FBI identified at least 16 Conti ransomware attacks targeting US healthcare and first responder networks, including law enforcement agencies, emergency medical services, 9-1-1 dispatch centers, and municipalities within the last year.

These healthcare and first responder networks are among the more than 400 organizations worldwide victimized by Conti, over 290 of which are located in the U.S.

Like most ransomware variants, Conti typically steals victims' files and encrypts the servers and workstations in an effort to force a ransom payment from the victim.

The ransom letter instructs victims to contact the actors through an online portal to complete the transaction.

If the ransom is not paid, the stolen data is sold or published to a public site controlled by the Conti actors.

Ransom amounts vary widely and we assess are tailored to the victim. Recent ransom demands have been as high as $25 million.

Cyber attacks targeting networks used by emergency services personnel can delay access to real-time digital information, increasing safety risks to first responders and could endanger the public who rely on calls for service to not be delayed.

Loss of access to law enforcement networks may impede investigative capabilities and create prosecution challenges.

Targeting healthcare networks can delay access to vital information, potentially affecting care and treatment of patients including cancellation of procedures, rerouting to unaffected facilities, and compromise of Protected Health Information.

Technical Details

Conti actors gain unauthorized access to victim networks through weaponized malicious email links, attachments, or stolen Remote Desktop Protocol (RDP) credentials.

Conti weaponizes Word documents with embedded Powershell scripts, initially staging Cobalt Strike via the Word documents and then dropping Emotet onto the network, giving the actor access to deploy ransomware.

Actors are observed inside the victim network between four days and three weeks on average before deploying Conti ransomware, primarily using dynamic-link libraries (DLLs) for delivery.

The actors first use tools already available on the network, and then add tools as needed, such as Windows Sysinternals and Mimikatz to escalate privileges and move laterally through the network before exfiltrating and encrypting data.

In some cases where additional resources are needed, the actors also use Trickbot.

Once Conti actors deploy the ransomware, they may stay in the network and beacon out using Anchor DNS.

If the victim does not respond to the ransom demands two to eight days after the ransomware deployment, Conti actors often call the victim using single-use Voice Over Internet Protocol (VOIP) numbers.

The actors may also communicate with the victim using ProtonMail, and in some instances victims have negotiated a reduced ransom. View the entire report below.

To read more:
https://www.aha.org/system/files/media/file/2021/05/fbi-tlp-white-report-conti-ransomware-attacks-impact-healthcare-and-first-responder-networks-5-20-21.pdf

The Federal Reserve's New Framework and Outcome-Based Forward Guidance

Vice Chair Richard H. Clarida , at "SOMC: The Federal Reserve's New Policy Framework" a forum sponsored by the Manhattan Institute's Shadow Open Market Committee, New York, New York

On August 27, the Federal Open Market Committee (FOMC) unanimously approved a revised Statement on Longer-Run Goals and Monetary Policy Strategy, and, at its September and December FOMC meetings, the Committee made material changes to its forward guidance to bring it into line with this new policy framework.

Before I discuss the new framework and the policy implications that flow from it, I will first review some important changes in the U.S. economy that motivated the Committee to assess ways we could refine our strategy, tools, and communication practices to achieve and sustain our goals in the economy in which we operate today and for the foreseeable future.

Shifting Stars and the End of "Copacetic Coincidence"

Perhaps the most significant change in our understanding of the economy since the Federal Reserve formally adopted inflation targeting in 2012 has been the substantial decline in estimates of the neutral real interest rate, r*, that, over the longer run, is consistent with our maximum-employment and price-stability mandates.

Whereas in January 2012 the median FOMC participant projected a longer-run r* of 2.25 percent and a neutral nominal policy rate of 4.25 percent, as of March 2021, the median FOMC participant projected a longer-run r* equal to just 0.5 percent, which implies a neutral setting for the federal funds rate of 2.5 percent.

Moreover, as is well appreciated, the decline in neutral policy rates since the Global Financial Crisis (GFC) is a global phenomenon that is widely expected by forecasters and financial markets to persist for years to come (Clarida, 2019).

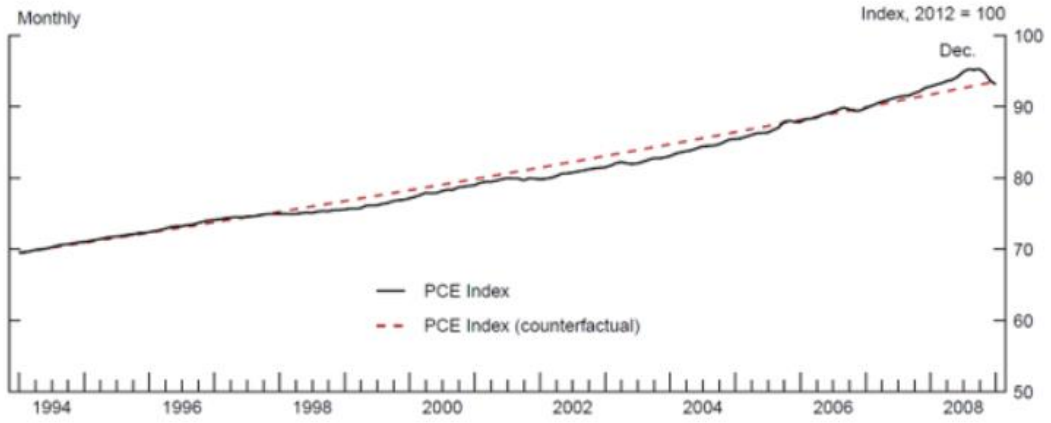
The substantial decline in the neutral policy rate since 2012 has critical implications for monetary policy because it leaves the FOMC with less conventional policy space to cut rates to offset adverse shocks to aggregate demand.

This development, in turn, makes it more likely that recessions will impart elevated risks of more persistent downward pressure on inflation and inflation expectations as well as upward pressure on unemployment that the Federal Reserve's monetary policy should—in design and implementation—seek to offset throughout the business cycle and not just in downturns themselves.

With regard to inflation expectations, there is broad agreement that achieving price stability on a sustainable basis requires that long-run inflation expectations be well anchored at the rate of inflation consistent with the price-stability goal.

The pre-GFC academic literature (Clarida, Galí, and Gertler, 1999; Woodford, 2003) derived the important result that a credible inflation-targeting monetary policy strategy that is not constrained by the effective lower bound (ELB) can deliver, under either rational expectations or linear least-squares learning (Bullard and Mitra, 2002), inflation expectations that themselves are well anchored at the inflation target.

Figure 1. U.S. Personal Consumption Expenditures Price Index



Note: The counterfactual U.S. Personal Consumption Expenditures Price Index (PCE Index) measures the value if inflation grew at 2 percent annually.
Source: Bloomberg Finance LP; Federal Reserve Board staff calculations.

In other words, absent a binding ELB constraint, a policy that targets actual inflation in these models delivers long-run inflation expectations well anchored at the target "for free." And, indeed, in the 15 years before December 2008, when the federal funds rate first hit the ELB—a period when, de facto, if not de jure the Federal Reserve conducted a monetary policy that was interpreted to be targeting an inflation rate of 2 percent (Clarida, Galí, and Gertler, 2000)—personal consumption expenditures (PCE) inflation averaged very close to 2 percent (see figure 1).

But this "copacetic coincidence" no longer holds in a world of low r* in which adverse aggregate demand shocks drive the economy in downturns to the ELB.

In this case, economic analysis indicates that flexible inflation-targeting monetary policy cannot be relied on to deliver inflation expectations that are anchored at the target but instead will tend to deliver inflation expectations that, in each business cycle, become anchored at a level below the target (Mishkin, 2016).

This finding is the crucial insight in my colleague John Williams's research with Thomas Mertens (2019) and in the research of Bernanke, Kiley, and Roberts (2019).

This downward bias in inflation expectations under inflation targeting in an ELB world can in turn reduce already scarce policy space—because nominal interest rates reflect both real rates and expected inflation—and it can open up the risk of the downward spiral in both actual and expected inflation that has been observed in some other major economies.

Two other, related developments that have also become more evident than they appeared in 2012 are that price inflation seems empirically to be less responsive to resource slack, and that estimates of resource slack based on historically estimated price Phillips curve relationships are less reliable and subject to more material revision than was once commonly believed.

For example, in the face of declining unemployment rates that did not result in excessive cost-push pressure to price inflation, the median of the Committee's projections of u*—the rate of unemployment consistent in the longer run with the 2 percent inflation objective—has been repeatedly revised lower, from 5.5 percent in January 2012 to 4 percent as of the March 2021 Summary of Economic Projections (SEP).

In the past several years of the previous expansion, declines in the unemployment rate occurred in tandem with a notable and, to me, welcome increase in real wages that was accompanied by an increase in labor's share of national income, but not a surge in price inflation to a pace inconsistent with our price-stability mandate and well-anchored inflation expectations.

Indeed, this pattern of mid-cycle declines in unemployment coincident with noninflationary increases in real wages and labor's share has been evident in the U.S. data since the 1990s (Clarida, 2016; Heise, Karahan, and Sahin, 2020; Feroli, Silver, and Edgerton, 2021).

The New Framework and Price Stability

I will now discuss the implications of the new framework for the Federal Reserve's price-stability mandate before turning to its implications for the maximum-employment mandate. Five features of the new framework and fall 2020 FOMC statements define how the Committee will seek to achieve its price-stability mandate over time.

First, the Committee expects to delay liftoff from the ELB until PCE inflation has risen to 2 percent and other complementary conditions, consistent with achieving this goal on a sustained basis, have also been met.

Second, with inflation having run persistently below 2 percent, the Committee will aim to achieve inflation moderately above 2 percent for some time in the service of keeping longer-term inflation expectations well anchored at the 2 percent longer-run goal.

Third, the Committee expects that appropriate monetary policy will remain accommodative for some time after the conditions to commence policy normalization have been met.

Fourth, policy will aim over time to return inflation to its longer-run goal, which remains 2 percent, but not below, once the conditions to commence policy normalization have been met.

Fifth, inflation that averages 2 percent over time represents an ex ante aspiration of the FOMC but not a time inconsistent ex post commitment.

As I highlighted in speeches at the Brookings Institution in November and the Hoover Institution in January, I believe that a useful way to summarize the framework defined by these five features is temporary price-level targeting (TPLT, at the ELB) that reverts to flexible inflation targeting (once the conditions for liftoff have been reached).

Just such a framework has been analyzed by Bernanke, Kiley, and Roberts (2019) and Bernanke (2020), who in turn build on earlier work by Evans (2012), Reifschneider and Williams (2000), and Eggertsson and Woodford (2003), among many others.

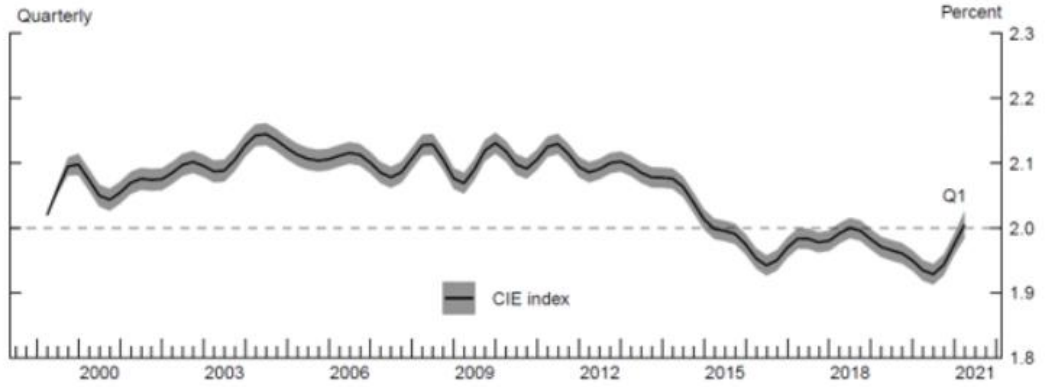
A policy that delays liftoff from the ELB until a threshold for average inflation has been reached is one element of a TPLT strategy. Starting with our September FOMC statement, we communicated that inflation reaching 2 percent is a necessary condition for liftoff from the ELB. TPLT with such a one-year memory has been studied by Bernanke, Kiley, and Roberts (2019).

The FOMC also indicated in these statements that the Committee expects to delay liftoff until inflation is "on track to moderately exceed 2 percent for some time." What "moderately" and "for some time" mean will depend on the initial conditions at liftoff (just as they do under other versions of

TPLT), and the Committee's judgment on the projected duration and magnitude of the deviation from the 2 percent inflation goal will be communicated in the quarterly SEP for inflation.

Our new framework is asymmetric. That is, as in the TPLT studies cited earlier, the goal of monetary policy after lifting off from the ELB is to return inflation to its 2 percent longer-run goal, but not to push inflation below 2 percent. In the case of the Federal Reserve, we have highlighted that making sure that inflation expectations remain anchored at our 2 percent objective is just such a consideration. Speaking for myself, I follow closely the Fed staff's index of common inflation expectations (CIE)—which is now updated quarterly on the Board's website—as a relevant indicator that this goal is being met (see figure 2).

Figure 2. Estimated Index of Common Inflation Expectations



Note: The horizontal dashed line is marked at 2 percent. The common inflation expectations (CIE) index is projected onto the Survey of Professional Forecasters 10-year personal consumption expenditures inflation value. The shaded area denotes the 95 percent confidence interval.

Source: Ahn and Fulton (2020, 2021); authors' calculations.

Other things being equal, my desired pace of policy normalization post liftoff to return inflation to 2 percent would be somewhat slower than otherwise if the CIE index at the time of liftoff is below the pre-ELB level.

Our framework aims ex ante for inflation to average 2 percent over time but does not make a commitment to achieve ex post inflation outcomes that average 2 percent under any and all circumstances. The same is true for the TPLT studies I cited earlier. In these studies, the only way in which average inflation enters the policy rule is through the timing of liftoff itself.
Yet in stochastic simulations of the FRB/US model under TPLT with a one-year memory that reverts to flexible inflation targeting after liftoff, inflation does average very close to 2 percent (see the table).

Table 1. Stochastic Simulation Result of FRB/US Model under Model-Consistent Expectations

	ELB frequency (percent)	Mean duration of ELB (quarters)	Mean output gap	Mean inflation rate	RMSD of output gap	RMSD of inflation rate	Loss
1. Taylor	38.3	10.9	-1.1	1.2	3.5	2.2	17.2
2. Taylor (inertial)	33.6	20.7	-1.4	1.0	3.9	2.4	20.7
3. Flexible price-level target	32.6	8.5	-0.4	2.0	3.6	1.5	15.2
4. Flexible price-level target (inertial)	24.6	13.8	-0.6	2.0	4.4	1.5	21.8
5. Flexible temporary price-level target	17.6	12.9	0.3	2.4	3.4	1.6	14.5
6. Temporary price-level target	16.3	12.5	0.0	2.3	3.1	1.7	12.6
7. Temporary price-level target (3-year memory)	15.6	11.2	0.3	2.4	2.7	1.6	9.6
8. Temporary price-level target (1-year memory)	15.1	9.4	0.2	2.3	2.5	1.5	8.5
9. Reifschneider-Williams	28.1	10.1	0.2	2.1	2.4	1.6	8.0
10. Kiley-Roberts change rule	37.0	16.9	-0.1	2.1	1.9	1.4	5.7

Results are based on 500 simulations of 100 quarters each. $Loss = \frac{1}{N}\frac{1}{K}\Sigma_{j=1}^{K}\Sigma_{t=1}^{N}\left[(\pi_{t,j}-\pi^{*})^{2}+\hat{\gamma}_{t,j}^{2}\right]$ for t , j period-simulations. FRB/US is the Federal Reserve's principal simulation model; ELB is effective lower bound; RMSD is root mean square deviation.

Source: Bernanke, Kiley, and Roberts (2019); authors' calculations.

The model of Mertens and Williams (2019) delivers a similar outcome: Even though the policy reaction function in their model does not incorporate an ex post makeup element, it delivers a long-run (unconditional) average rate of inflation equal to target by aiming for a moderate inflation overshoot away from the ELB that is calibrated to offset the inflation shortfall caused by the ELB.

The New Framework and Maximum Employment

I turn now to the maximum-employment mandate. An important evolution in our new framework is that the Committee now defines maximum employment as the highest level of employment that does not generate sustained pressures that put the price-stability mandate at risk.

As a practical matter, this means to me that when the unemployment rate is elevated relative to my SEP projection of its long-run natural level, monetary policy should, as before, continue to be calibrated to eliminate

such employment shortfalls, so long as doing so does not put the price-stability mandate at risk.

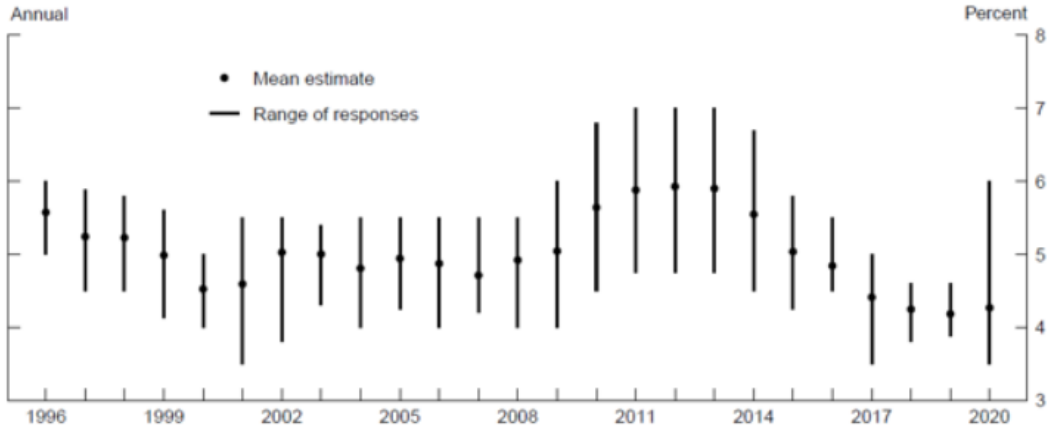
Indeed, in our September and subsequent FOMC statements, we indicated that we expect it will be appropriate to keep the federal funds rate in the current 0 to 25 basis point target range until inflation has reached 2 percent (on an annual basis) and labor market conditions have reached levels consistent with the Committee's assessment of maximum employment.

Moreover, in our December and subsequent FOMC statements, we have indicated that we expect to continue our Treasury and MBS purchases at least at the current pace until we have made substantial further progress toward achieving these dual mandate goals.

In our new framework, when in a business cycle expansion labor market indicators return to a range that in the Committee's judgment is broadly consistent with its maximum-employment mandate, it will be data on inflation itself that policy will react to, but, going forward, policy will not tighten solely because the unemployment rate has fallen below any particular econometric estimate of its long-run natural level.

Of note, the relevance of uncertainty about the natural rate of unemployment or the output gap for monetary policy reaction functions is a long-studied topic that remains important.12 For example, Berge (2020) provides a discussion around the difficult task of estimating the output gap (see figure 3).

Figure 3. Survey of Professional Forecasters Estimates of the Natural Rate



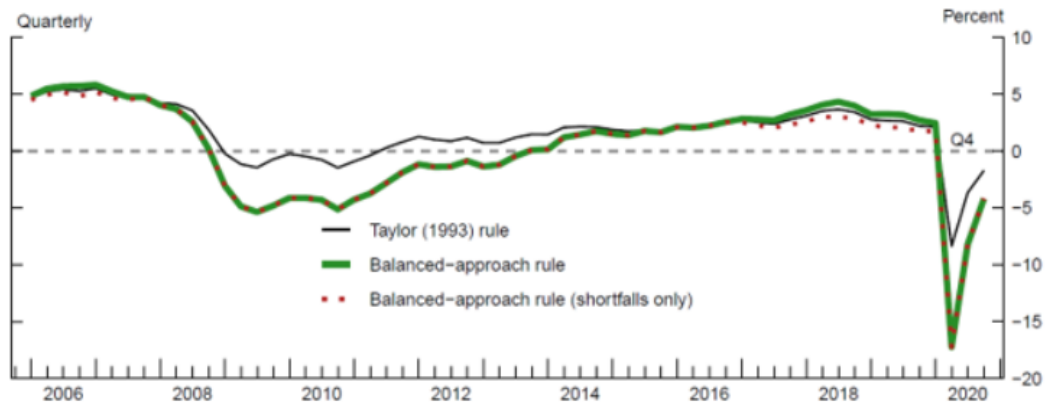
Source: Survey of Professional Forecasters.

These considerations have an important implication for the Taylor-type policy reaction function I consult.

Consistent with our new framework, the relevant policy rule benchmark I will consult once the conditions for liftoff have been met is an inertial Taylor-type rule with a coefficient of zero on the unemployment gap, a coefficient of 1.5 on the gap between core PCE inflation and the 2 percent longer-run goal, and a neutral real policy rate equal to my SEP projection of long-run r*.

The most recent Monetary Policy Report features a box on policy rules, including a Taylor-type "shortfalls" rule in which the federal funds rate reacts only to shortfalls of employment from the Committee's best judgment of its maximum level but reverts to the rule previously described once that level of employment is reached (see figure 4).

Figure 4. Historical Federal Funds Rate Prescriptions from Simple Policy Rules



Notes: The horizontal dashed line is marked at zero. The Taylor (1993) rule was suggested in John B. Taylor (1993), "Discretion versus Policy Rules in Practice," *Carnegie-Rochester Conference Series on Public Policy*, vol. 39 (December), pp. 195–214. The balanced-approach rule was analyzed in John B. Taylor (1999), "A Historical Analysis of Monetary Policy Rules," in John B. Taylor, ed., *Monetary Policy Rules* (Chicago: University of Chicago Press), pp. 319–41. The rules use historical values of the federal funds rate, core personal consumption expenditure inflation, and the unemployment rate. Quarterly projections of longer-run values for the federal funds rate and the unemployment rate are derived through interpolations of the biannual projections from Blue Chip Economic Indicators. The longer-run value for inflation is taken as 2 percent.

Source: Federal Reserve Bank of Philadelphia; Wolters Kluwer, Blue Chip Economic Indicators; Federal Reserve Board staff estimates.

Concluding Remarks

In closing, I think of our new flexible average inflation-targeting framework as a combination of TPLT at the ELB, to which TPLT reverts once the conditions to commence policy normalization articulated in our most recent FOMC statement have been met.

In this sense, our new framework indeed represents an evolution, not a revolution, from the flexible inflation-targeting framework in place since 2012. Thank you very much for your time and attention, and I look forward to my conversation with Peter Ireland and Athanasios Orphanides.

From master masons to information architects: how standards can transform reporting (and bring benefits well beyond it)

Gareth Ramsay, Executive Director for Data and Analytics & Chief Data Officer of the Bank of England, webinar hosted by The EDM Council

Hello all – it's a great pleasure to be speaking to you. I'd like to thank John Bottega and the EDM Council for virtually hosting us today.

I want to begin by talking about cathedrals.

The great cathedrals of Europe were built in the Middle Ages by teams of skilled stone masons.

To get the dimensions of the building right, it is said that each team would use measures based around the body of the master mason: his foot, his stride, his arm, and so on. And so a local standard was born.

Those standards were designed with one specific use in mind – the construction of that cathedral. And very useful they were, too. But they were closed systems – the foot and the yard used to build one cathedral were different from those used to build another.

And this was not just an English peculiarity: across the channel, a foot length in Strasbourg was 295 mm, a foot in Paris was 325 mm, but a foot in Bordeaux was a relative whopper at 344 mm.

Of course people came to understand the great benefits of enforcing universal, common standards.

In part for maintaining the cathedrals themselves, so that new, replacement stones could be sourced that would fit snugly between their neighbours.

But the benefits of universal measurement standards could be applied a long way beyond the niche discipline of cathedral building.

Now some of you may think that today's financial system is not perfectly comparable to the glorious gothic cathedrals of the Middle Ages.
But like those cathedrals, many of the data systems underpinning today's financial firms and markets were built with narrow reference to their own needs, by their own master masons – their CIOs and systems architects.

They too were closed systems. Each needed to be able to record, track and manipulate its data.

Its data points needed to fit snugly alongside each other. But the design of each system often paid little attention – understandably – to any broader public good.

In this speech, I want to talk about whether there are wider public benefits that might flow from standardising these data labels, and set out a way forward to reap those benefits collectively.

So let me turn from mediaeval architecture to data.

At a central bank like the Bank of England, data is our life blood. We depend on our ability to access it, analyse it, and draw conclusions from it to set policies.

Effective management and use of data is how we meet our goals.

Of course, we are far from alone here – many organisations rely heavily on their use of data. But we are, perhaps, different to many in that the vast majority of the data we want is generated by others rather than ourselves.

The data we care about is the sum of millions of financial and economic interactions, taking place every second. And much of that data is captured and stored by financial institutions, as they go about serving their customers.

We need to get our hands on that data. We need data on the financial system in aggregate and also on specific markets within it, to help us understand where risks are emerging and to help us calibrate policies to maintain stability. And we need data about individual regulated firms, for our work as supervisor and as resolution authority.

So we have built data collection processes to give us that data. We publish reporting instructions. Firms then go through various steps: they interpret our instructions, identify the right data within their systems, put in place processes to integrate, cleanse and check the data, and then sign it off and deliver it to us.

But the amount of data we collect through these processes has been growing. It's hard to capture all of our data collections in a single measure. But the accompanying chart shows the number of data points we collect through our regular rule-based banking collections.

Since 2014, this has grown around seven-fold. This growth has partly been a response to the financial crisis of 2008, when regulators and authorities

around the world discovered huge gaps in what they knew, and what they could see, of risks emerging in the financial sector.

At the same time, technological change has been increasing the volume of data being produced, and the demands we can put upon the data. Like many of the financial firms we regulate, we want to make more extensive use of this bountiful data, using bigger datasets and newer, more complex analytical techniques.

These developments – the availability of, and need for, more data, and the desire to do more with it – have put growing strains on the processes and systems we use to collect it in the first place. That poses a growing challenge for us and for firms who are sending us the data, each firm doing so independently and in a different way.

And if it's hard for firms to supply us the right data, well, that matters for us. It may take industry longer to meet our requests. And if different firms interpret our requests in different ways, that makes it harder for us to draw conclusions from the data we receive.

To read more:
https://www.bankofengland.co.uk/speech/2021/april/gareth-ramsay-webinar-hosted-by-the-edm-council

Covid-related fiscal measures and debt sustainability

Prof Claudia Buch, Vice-President of the Deutsche Bundesbank, at the ESM seminar on debt sustainability Panel II "Policy implications in the new normal".

The pandemic has been a stress test for the global financial system

The coronavirus pandemic has been the biggest stress test for the global financial system in recent decades. It was unexpected, it has been truly global, and it has differed in scale and scope from the global financial crisis in 2008.

In the global financial crisis, excessive leverage in the banking sector led to contagion and a financial crisis that impaired the functioning of the financial system. The coronavirus pandemic, in contrast, threatens the liquidity and solvency of the corporate sector.

So far, the financial system has weathered the storm and continued to function – because policy coordination has worked well during this crisis. Fiscal and monetary policy responses have been bold and timely.

The financial system has proven to be robust: Thanks to the G20 regulatory reforms following the global financial crisis, the banking system is better capitalized, and there is greater regulatory flexibility to reduce pro-cyclicality. Policy responses have been coordinated internationally.

However, key challenges for debt sustainability and financial stability may still lie ahead. Dealing with increasing insolvencies, maintaining crisis-related policy support only as long as necessary, and ensuring financial sector resilience will be among the policy priorities going forward.

There is still a high degree of uncertainty concerning the future evolution of the pandemic and the damage that has been done to the real economy.

One cannot rule out an adverse scenario with feedback loops to the real economy if banks deleverage to meet capital requirements imposed by regulators or markets.
Hence, monitoring the interaction between debt sustainability in the public sector, the corporate sector, and the banking sector will be crucial.

Recognising the importance of fiscal support for financial stability, the European Systemic Risk Board (ESRB) has established a regular monitoring framework.

Since mid-2020, the 30 ESRB Member States have reported the size and uptake of fiscal policy support measures on a quarterly basis (ESRB 2020, 2021). The measures include loan moratoria, public loans and guarantees, direct grants, and tax deferrals, among others.

The reporting has three parts covering the characteristics and volume of measures, their uptake, and qualitative information. Data on characteristics of measures like their announced size, end-dates, or eligibility criteria are made publicly available.

To read more: https://www.bis.org/review/r210423b.pdf

Andrew Bailey: Meeting varied people

Andrew Bailey, Governor of the Bank of England, at Diversity in Market Intelligence: Launching our Meeting Varied People Initiative.

Thank you Andrea for that introduction, and thank you to everyone for joining us today.

People often talk about diversity in terms of the makeup of their own workforces – and for a public institution like the Bank, it is vital we reflect the whole society we serve.

This includes both identity and cognitive diversity, which are equally important. I often say I don't want to work in a place that is full of people like me.

I want the Bank to have an inclusive and open culture where people speak up, ensuring we make better decisions by mitigating the risks of groupthink and myopia.

Over recent years, a number of my colleagues at the Bank have also emphasised the importance of diversity and inclusion, both for us as an employer, and as a wider public good for the financial sector.

We have made significant progress internally: for example, launched our Out & Proud Action Plan in September 2020, and continue to sponsor the 'Women in Finance' Charter.

But there is always more to be done, which is why for example we recently initiated a review, led by our Court of Directors, on ethnic diversity and inclusion. I know that many of you are doing similar work within your firms.

As Andrea mentioned, the focus today is our approach to encouraging diversity in our financial market intelligence contacts, and the networks we engage with.

Our priority is to speak to a diverse group of people from a broad range of financial institutions.
Our discussions with market participants help us understand market developments, and the implications for our Policy Committees.

So all of the arguments about why diversity is important internally here at the Bank of England hold just as firmly when we engage with you externally.

We are embedding that approach into our core market intelligence framework, to underscore our commitment.

So why is this a priority for us? First and foremost, it's the right thing to do. As a public institution, we need to represent the diversity of the country in what we look like, who we talk to and the impact of our decisions.

But, just as importantly, it helps us achieve our objectives. Our mission is to promote the good of the people of the United Kingdom by maintaining monetary and financial stability. And diversity in its many forms is a critical part of delivering that mission.

Improved cognitive diversity helps make for better decision making. The lack of such diversity has been highlighted as one important factor in the bank and regulatory failures of 2008.

Having a diverse range of institutions and business models brings positive benefits for financial system resiliency – something that you will not be surprised to hear matters a great deal to the Bank of England!

Diversity in who we speak to in financial markets has even more direct benefits. It improves our understanding of what is driving markets, what people expect from future policy and the potential impacts of different decisions.

And that is critical – because financial markets are global, complex and interconnected.

A failure to understand those diverse components heightens the chances of making analytical, and hence policy, mistakes.

Speaking to only one subset of banks, for example, could mean policy calibrations have unintended consequences for different market participants.

Only looking at established financial assets risks ignoring the impact of innovation. And speaking only to contacts of similar backgrounds could mean missing different perspectives on potential risks to consensus views. Having that breadth of diverse perspectives allows us to act more quickly and decisively in a crisis too.

In March last year, financial market stress caused by COVID-19 across the world led to investors looking for safe haven assets and cash.

The conversations we had with market participants like you during this period were essential to building a picture of what was happening across a wide range of different markets, and assessing the steps we, and other public authorities, needed to take to maintain economic and financial stability.

To take one example, the intelligence we gathered from you about the stress in the commercial paper market helped the Bank and HM Treasury to plan, design and launch the COVID Corporate Funding Facility in record time, and ensured it was priced appropriately.

Similarly, our market intelligence helped ensure that the other elements of the policy response last year were also rapid, decisive and well calibrated to the underlying risks.

Of course, diversity has affected our other outreach activity too. When I first started working at the Bank of England in the mid-1980s, the Bank's only public statements came mainly from the Governor for instance at the annual Mansion House speech.

We have moved a long way since then, and we see outreach as core to how we operate.

In an important sense this change naturally accompanied the decisive shift to the Bank having clear and independent responsibility for monetary policy and the stability of the financial system.

With those responsibilities went a duty to reach out and communicate much more broadly.

Our network of regional Agents help us with ensuring we speak to companies and organisations from across the country.

We created Citizens Panels – held regularly all over the country in person and, for the time being, virtually – to understand how the public view the economy.

Our Community Forum programme enables us to meet with those who run third-sector organisations, as well as the people they support, across the UK.

Our work in diversity and inclusion extends to our role in creating an inclusive financial sector and I am pleased that with the input of many in the Islamic finance community, we are launching the Alternative Liquidity Facility (ALF) during the course of 2021.

So diversity matters to us. The update of our Market Intelligence Charter and the UK Money Markets Code, published today, will embed diverse outreach into our working practices and help make diversity within financial markets a core standard of best practice.

The Charter sets out our aims and ambitions of talking to a diverse range of contacts and affirms our commitment to open engagement, with an emphasis on challenge and diversity of thought.

The updated Code, which the FCA have recently again recognised as an industry standard, puts the expectation to promote and develop a diverse team upfront, alongside other core principles of best practice, highlighting the benefits of accessing a wider range of skills and thinking.

This approach is also being in embedded in our outward-facing markets committees. We currently have two main committees: the Money Markets Committee and the FX Joint Standing Committee.

We have been working with members from both committees to diversify their membership for some time now: including working to ensure women in senior roles are represented; and that the committees see a wider range of presenters at different stages of the career.

This is yielding results: specifically, female representation – which is one aspect of diversity that has been historically lacking on many senior-level committees – is now approaching half on the UK Money Markets Committee, and has climbed to around a third for the FX Joint Standing Committee in the past 18 months.

These changes were driven by the Bank but importantly with the full support of the external members.

We want to continue to work together with all of you here on this agenda. We look forward to hearing your ideas, suggestions and questions through the panel discussion coming up shortly, and in our networking session with our market intelligence teams later on today.

We want to use that as a starting point to build stronger links with a wider, more diverse group of colleagues, and also deepen those over time, as they progress through their careers.

There is a very important further issue in all of this, which is sadly highly topical, namely to ask what is the antidote to the problem of lobbying? The answer is not to speak to no-one.

That is not likely to lead to good decision making. The answer is to be rigorous about speaking to a diverse range of people to get their views.

We look forward to engaging with you in the future, working together to understand financial market developments from a diverse and varied range of perspectives to inform our policy committee decisions.

Thank you. I am grateful to Christine Boykiw, Sumita Ghosh, Sam Juthani, Ankita Mehta and Arjun Popat for their assistance in helping me prepare these remarks.

Werewolves of Change: Remarks before the ISDA Derivatives Trading Forum on Regulatory Change

Commissioner Hester M. Peirce, U.S. Securities and Exchange Commission

Thank you, Scott [O'Malia], for that kind introduction and for inviting me to be part of today's Derivatives Trading Forum. I will begin with my standard disclaimer that the views that I represent are my own and not necessarily those of the Securities and Exchange Commission or my fellow Commissioners.

Indeed, that disclaimer is particularly important at a time of leadership transition. We just last week welcomed a new chairman—Gary Gensler. Although he is still getting settled in, the Commission will soon be busy addressing the issues that he identifies as priorities for the coming months and years. Chairman Gensler is, of course, something of a known quantity for many of you in this audience.

Those of you who have been in the industry for a while had the opportunity to see him hard at work during his tenure as chairman of our sister agency, the Commodity Futures Trading Commission. Indeed, Scott [O'Malia], as a Commissioner of the CFTC, worked alongside Chairman Gensler during that time.

Those of you who have come to the industry more recently are doing business under a regulatory framework for swaps that is, in large part, the product of Chairman Gensler's vision. I anticipate that he will apply the same work ethic and outlook to his new role as Chairman of the SEC, informed, of course, by the experience that we have had with that regulatory framework in the intervening years.

Before we turn to some issues that Chairman Gensler faces as he begins his tenure at the SEC, let us look back to a 1940 speech relevant to the theme of today's forum by a prior chairman of the SEC, Chairman Jerome Frank.

He explained that, while change for its own sake is not praiseworthy, sometimes even when legal change is needed—as it might be in response to a new technology—people resist it. He observed that change pushes people, who have an affinity for routine, out of their comfort zone: Recognizableness confers immense emotional satisfaction. The new requires adjustment, reorientation. Disequilibrium results which is unpleasant, fatiguing. Interruption of routine demands reflective thinking,

keeping the mind in suspense while making judgments. And there is pain in every suspended judgment. Most of us, most of the time, are routineers who want to avoid that pain, that uncomfortable condition of tension. The old settled ways do not provoke mental discomfort, do not awake us from pleasantly tranquil dogmatic slumber.

He closed the speech with an enticing line from a short story by Peter Fleming, brother of James Bond author Ian Fleming. The protagonist in that short story "describes his uncle as a man 'not cursed with overmuch imagination, who saw no reason to cross frontiers of habit which the years had hallowed into rigidity.'"

Chairman Frank went on to explain: "That uncle, who detested the unusual, had, be it noted, a child who was a werewolf." "The story," Frank concluded, "is a parable."

Unable to resist Chairman Frank's teaser, I proceeded to disregard my aversion for scary stories and read The Kill.

In Fleming's tale, the werewolf son, rejected by his creature-of-habit father, takes revenge on the heirs installed in the disowned son's place by ripping out their throats.

Had I not been guided by Chairman Frank's literary analysis, I am quite sure that I would not have spotted the parable about the importance of getting out of our comfort zones and adapting to change. Read through Frank's filter, the message seems to be that if you do not embrace change, change will grab you ruthlessly by the throat—an appropriately cautionary watchword for today's forum on regulatory change.

With that unsettling thought in mind, let us talk about LIBOR. As you all know well, most LIBOR tenors will disappear by the end of this year, and the rest will be gone a year-and-a-half later.

A month ago, Randy Quarles, Vice Chair for Supervision at the Federal Reserve, acknowledging that "[a]djusting to a new reality can be difficult," made it very clear that "[t]here is no scenario in which a panel-based USD LIBOR will continue past June 2023, and nobody should expect it to."

Trillions of dollars of contracts that reference LIBOR, however, remain, and market participants have continued over the past year to build LIBOR into contracts.

Some of these LIBOR-based contracts have effective fallback language to address the impending cessation of LIBOR, but many do not.

Making the shift to alternative reference rates presents an unprecedented mix of legal, operational, systems, and business challenges across the financial industry and the broader marketplace. In the eyes of one regulatory observer, this transition marks "the largest financial infrastructure change to date, surpassing in size and complexity the conversion to the Euro and the Y2K conversion."

Unlike the Y2K conversion, we are not going to wake up one day to realize we have nothing more to worry about; we will be waking up to thorny LIBOR transition issues years from now.

I appreciate the work that ISDA has done to help facilitate the transition among participants in the derivatives markets with its fallbacks protocol and more generally with its early appreciation of the magnitude of this change and the importance of alerting market participants to it. Outside of the world of large swaps dealers, many market participants are not as far along in confronting and addressing the issue.

The SEC continues to pay close attention to developments in this area. Through the Alternative Reference Rates Committee (ARRC) and other avenues, the SEC has been working closely with our fellow regulators, regulated entities, and issuers to make sure that we all are taking steps to deal with the risks and challenges this change presents.

Given the number of entities and contracts affected, staff across the Commission are working on the LIBOR issue. Last summer, for example, our Division of Examinations issued a risk alert highlighting an examination initiative that would be looking at regulated firms' LIBOR transition readiness.

Among the issues of concern that the alert identified were

(1) exposures to LIBOR-linked contracts extending beyond the expected expiration date,

(2) operational readiness for transition to alternative reference rates,

(3) adequacy of disclosures to investors regarding firms' efforts to transition away from LIBOR, and

(4) potential conflicts of interest arising out of the transition to new reference rates. Staff across multiple SEC divisions and offices have been working with other regulators and communicating with regulated firms and issuers to identify and address other areas of concern.

In January, for example, the staff warned that LIBOR discontinuation "could have a significant impact on the municipal securities market and

may present a material risk for many issuers of municipal securities and other obligated persons."

Earlier this month, a subcommittee of the House Financial Services Committee held a hearing on LIBOR, which included representatives of the SEC and a number of other federal financial regulators.

The hearing centered around a piece of legislation under consideration in Congress that would provide fallback language for contracts that do not contain such language.

It is modelled on a recently passed New York law that would insert a replacement rate into "tough legacy contracts" that do not have fallback language.

This kind of legislation would override private contracts, which is a serious matter, but the alternative is a lot of litigation, which is also a serious matter.

As consideration of this legislation and other issues related to LIBOR transition continue to draw attention, the SEC will continue, in the words of our prior Chairman, Jay Clayton, to "encourage registrants to proactively transition to market-based reference rates and [to] stand ready to assist market participants."

Chairman Gensler is well equipped to lead the SEC's ongoing work in this area. In fact, when he was Chairman of the CFTC, he was already making the case for moving away from LIBOR. He acknowledged the magnitude of such an undertaking, but thought it worth the difficulty because "continuing to reference such rates diminishes market integrity and is unsustainable in the long run."

Apparently, not one to fall prey to the werewolves I mentioned above, in calling for "a smooth transition," he said "I recognize that change can be hard, but change is also a natural part of life."

As we move away from LIBOR because its precision masks a much more ambiguous reality, I am disconcerted that neither regulators nor market participants have learned the deeper lesson that the LIBOR debacle teaches us, namely the dangerous power of metrics that distort reality by creating the illusion of precision. We have not yet fully accounted for the costs of disentangling ourselves from the LIBOR web, yet we are rushing headlong into adopting measures in the ESG space that themselves convey an impression of precision while being very poorly calibrated to identifying meaningful responses to the problems that are cited to justify their adoption.

A common brown-to-green rating scale, for example, that appears to be a simple, useful tool in assessing an issuer or financial product, might in fact prove to be a simplistic measure that tells us nothing meaningful or that even inadvertently promotes environmentally destructive capital allocation.

Before we align the entire financial system around measures that convey an enticing, but perhaps inaccurate degree of certainty, we ought to reflect on our LIBOR experience. Former Governor of the Bank of England Mark Carney explained the problem with LIBOR this way:

Libor is meant to measure the short-term unsecured funding costs of banks. But the reality is that, since the financial crisis, Libor really has become the rate at which banks don't lend to each other. Bank funding markets have changed enormously. Banks no longer take sufficient short-term wholesale deposits to form the basis for a robust transaction-based Libor benchmark.

As a result Libor is overly reliant on expert judgement rather than actual transactions. And global markets remain overly reliant on Libor, a benchmark that may not exist beyond 2021. That reliance is neither desirable nor sustainable.

Similarly, we can build a neat set of ESG metrics that then get incorporated into a whole array of financial transactions, but if that neat set of metrics represents expert judgment rather than reality, will not capital be misallocated? If it conveys a false sense of confidence, will its mere presence not mislead investors and others?

As hard as it is to measure the rates at which banks lend to one another, it is even harder to measure how green a particular investment , issuer, or transaction is. Consider the decision about whether to invest in a multifamily apartment company.

An investment in the company might get the green light under existing taxonomies if the company announces plans to rip out all the natural gas stoves in its rental units and replace them with new electric stoves.

Yet, whether that decision really is green would depend on many factors, including whether the stoves need replacing, whether the old stoves will end up in a landfill, what kind of environmental effect the manufacture of the new stoves will have, and how the electricity to power the electric stoves will be sourced.

An energy project might get good green marks if it involves wind rather than fossil fuels, but can those marks incorporate the effect of wind turbines on bats and thus on pesticide use?

These are perhaps overly crude examples, but the point is that a lot of factors need to be weighed when making capital allocation decisions.

We all want to believe that we are making the world a better place. Helping investors to implement their ESG strategies is part of your contribution to doing so. I urge you all, however, to be cautious.

As people who understand better than most others that numbers, metrics, and models can lead and mislead, you have a responsibility to your shareholders and your customers not to embrace approaches that will harm the capital markets, the financial system, or the planet.

I understand there is often an immediate reputational benefit to signing on to initiatives that can be branded as pro-climate, sustainable, or ESG, but it would be ironic indeed if you tie your firms' fortunes (along with those of your shareholders and customers) to a movement that undermines those objectives and the financial system's ability to serve society for an illusory short-term reputational boost.

I will make the same cautionary pitch to my own agency as we too seek the reputational boost that ESG standard-setting would bring us. These issues are important ones, which only underscores the need to proceed with care.

Another more pedestrian issue on the agenda, but one where Chairman Gensler's experience will be an asset, is overseeing the implementation of the SEC's security-based swap framework for dealers. Thanks to the efforts of former Chairman Clayton, that registration regime is set to go live in the fall.

One of the unexpected pleasures that I had during my first three years as a Commissioner was the opportunity to work closely with Chairman Clayton on to complete work on our security-based swap dealer rulebook, something that was incomplete when Chairman Clayton arrived at the SEC. Before becoming a Commissioner, I raised many concerns about the Dodd-Frank Act and how regulators had implemented it.

When I became a Commissioner, though, my job description changed. Congress had charged the SEC with standing up a framework to regulate the security-based swap market, that work was unfinished when I arrived at the Commission, and it was now my responsibility as a member of the Commission to work to complete it.

During the nearly three years of my partnership with Chairman Clayton on this project, the Commission was able to refine the Commission's approach to several aspects of cross-border application of our rules; to provide tailored, time-limited relief intended to ease implementation by allowing reliance on existing CFTC frameworks; and to finalize the capital and

margin requirements for security-based swap dealers and major security-based swap participants. We also were able to issue the first substituted compliance determination, which I hope has helped pave the way toward effective and efficient regulation of this global market.

Much work remains to be done before the regime goes live in the fourth quarter of this year. We have issued a substituted compliance order for Germany, and we have two outstanding proposed substituted compliance orders (for France and the United Kingdom).

The comment period closes for these proposals on May 3. If you have comments or concerns, please get them in on time, and if you have not already talked to the staff, please do so. My hope is that the Commission will be able to move quickly on finalizing these orders, and your timely engagement with us and our staff is essential to achieving this objective.

Similarly, if your firm expects to rely on substituted compliance in a jurisdiction other than the ones I mentioned, please do what you can to ensure that the application for that jurisdiction is completed as soon as possible, including by reaching out to the local authorities if necessary. Time is running short: Analysis of these applications takes time, as does implementing necessary changes to your systems and operations.

Other aspects of the security-based swap regime are less pressing, but nevertheless on the agenda. For example, we have not adopted a registration regime for security-based swap execution facilities (SEFs). We issued a proposal in 2011 and reopened the comment period in 2013.

Given the developments in the industry in the meantime, we might want to reopen the comment period again before moving to a final rule. Regardless of how we proceed with the SEF regime, the security-based swap markets would not seem particularly conducive to mandates to centrally clear or trade on a SEF.

Along with LIBOR transition, implementation of the security-based swap dealer regime has been on the agenda for a long time now and was going to happen regardless of who became chairman of the SEC this year. If your firm is facing unexpected challenges in either of these areas, I hope you will reach out to the Commission. Given the importance of moving quickly, it is good that we have a new chairman who can hit the ground running on these issues.

Chairman Gensler knows these markets well, and I think he understands the importance of helping market participants navigate the challenges of operating a global business across a patchwork of local regulatory frameworks in various stages of development. If other implementation challenges remain—for example, I have heard some concerns persist

regarding implementation of initial margin requirements and trade reporting requirements—please continue to engage with us.

I suspect that many of you are wondering what other changes you have to look forward to under the new leadership at the SEC and other agencies. I share that interest and look forward to hearing Chairman Gensler set out his priorities for the coming months. Market events, of course, will dictate some of the agenda.

The staff is working on a report about the events related to meme stock trading earlier this year, and some regulatory initiatives may come out of that work. Similarly, as we understand more about the failure of Archegos Capital Management, discussion about regulatory changes might be appropriate.

As usual, commentators have gotten a head start and have identified a number of regulatory responses, including possible regulation of family offices and enhanced disclosure requirements for synthetic stock positions created through the use of total return swaps and possibly other derivative instruments.

Determining which proposed regulatory response will develop momentum is hard, and resisting that momentum once it has started is even more difficult. Let us not assume, as regulators so often do, that there is a problem and that since something needs to be done, any “something” will do. Let us instead carry out the necessary analyses to determine whether there is a problem that market participants cannot resolve on their own.

Preventing family offices from losing their fortunes is not in the category of problems that the SEC needs to step in to solve. I am much more interested in expanding access to our capital markets so that less well-heeled families can build their fortunes. Similarly, the mere fact that trading desks at some financial institutions lost a lot of money should not cause us a great deal of concern as long as their activity was consistent with our rules. The very nature of trading in the financial markets means that trading desks occasionally will lose money.

Financial regulators do have a legitimate interest in risk management at regulated entities, and it may be worth exploring whether there were problems in this area that need to be addressed. But even here, such events inevitably serve as lessons for risk managers (underscored by the demotions and firings that followed the Archegos failure), but they need not serve as justifications for more regulation.

The counterparties of market participants like Archegos have the strongest incentive to get their risk management processes correct and to determine whether those processes have weaknesses that need to be addressed. I

encourage you all to take this responsibility seriously, to identify weaknesses, and to work to remedy them.

Thank you for the chance to join you today. I would be happy to take your questions now. More importantly, looking forward to a road that is likely to be rich with regulatory change, I extend an offer to you to talk to me about how we can make that road smoother.

The goal is to achieve the intended objectives without unnecessarily inhibiting the ability of our markets to achieve their objective of serving people. Working together appropriately to adapt the regulatory framework to market developments, I am sure that we can keep the werewolves at bay.

Revisiting *NGFS Climate Scenarios for central banks and supervisors*

The NGFS Climate Scenarios explore the impacts of climate change and climate policy with the aim of providing a common reference framework.

• The NGFS Climate Scenarios (the scenarios) have been developed to provide a common starting point for analysing climate risks to the economy and financial system. While developed primarily for use by central banks and supervisors they may also be useful to the broader financial, academic and corporate communities. This document provides an overview of the key transition risks, physical risks and economic impact of climate change.

• The first iteration explores a set of eight scenarios which are consistent with the Framework published in the First NGFS Comprehensive Report.

The set includes three representative scenarios, which each cover one of the following dimensions:

– Orderly: Early, ambitious action to a net zero CO2 emissions economy;

– Disorderly: Action that is late, disruptive, sudden and / or unanticipated;

– Hot house world: Limited action leads to a hot house world with significant global warming and, as a result, strongly increased exposure to physical risks.

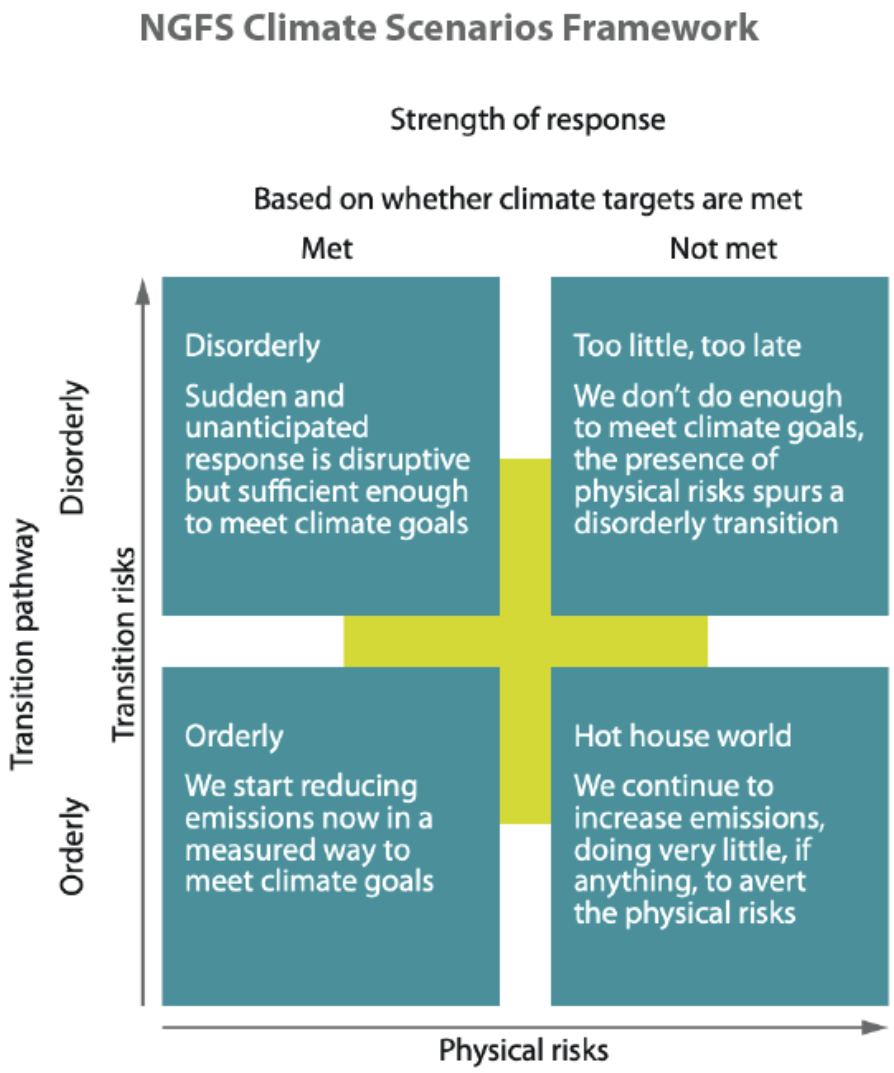
• These scenarios were chosen to show a range of lower and higher risk outcomes. A 'too little, too late' scenario with both high transition and physical risks was not included in the first iteration.

• A key guiding principle of the project has been embracing the uncertainty inherent in scenario modelling.

This has been captured in two ways.

Firstly, five alternate scenarios have been published to help users explore how specifying different key assumptions would change the results.

Secondly, for each scenario, multiple models have been used to provide a range of estimates.



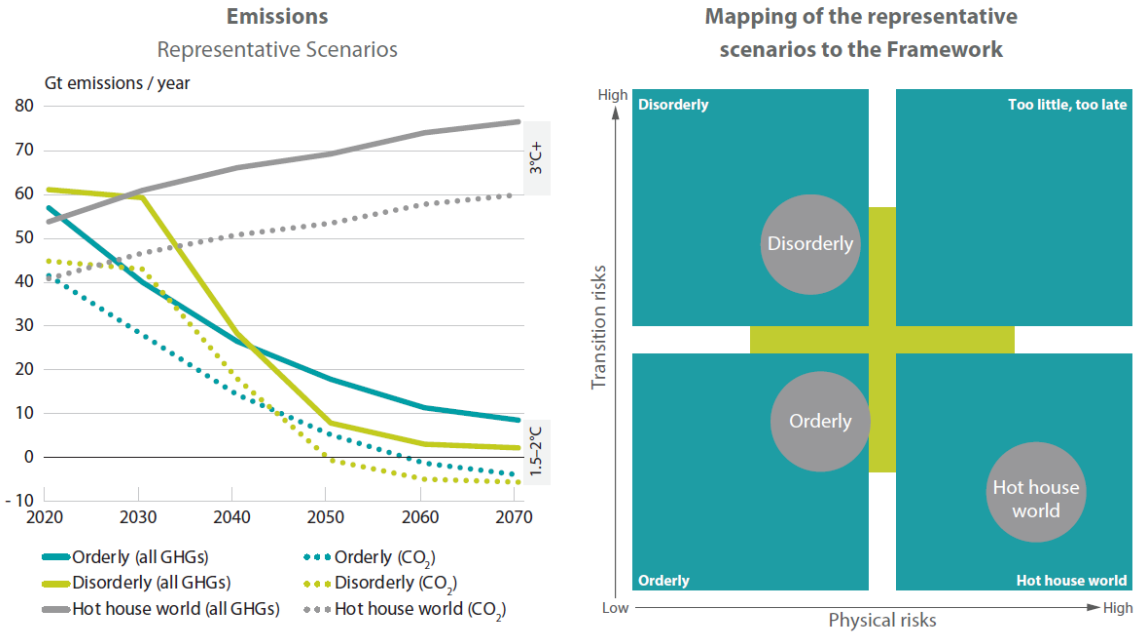
Source: NGFS (2019a).

The Orderly and Disorderly scenarios explore a transition which is consistent with limiting global warming to below 2°C. The Hot house world scenario leads to severe physical risks.

• *Orderly* assumes climate policies are introduced early and become gradually more stringent. Net zero CO2 emissions are achieved before 2070, giving a 67% chance of limiting global warming to below 2°C. Physical and transition risks are both relatively low.

• *Disorderly* assumes climate policies are not introduced until 2030. Since actions are taken relatively late and limited by available technologies, emissions reductions need to be sharper than in the Orderly scenario to limit warming to the same target. The result is higher transition risk.

• *Hot house world* assumes that only currently implemented policies are preserved. Nationally Determined Contributions are not met. Emissions grow until 2080 leading to 3°C+ of warming and severe physical risks. This includes irreversible changes like higher sea level rise.



Source: IIASA NGFS Climate Scenarios Database, using marker models.

To read more:
https://www.ngfs.net/sites/default/files/medias/documents/820184_ngfs_scenarios_final_version_v6.pdf

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Basel iii Compliance Professionals Association (BiiiCPA)

The Basel iii Compliance Professionals Association (BiiiCPA) is the largest association of Basel iii Professionals in the world. It is a business unit of the Basel ii Compliance Professionals Association (BCPA), the largest association of Basel ii Professionals in the world.

We invite you to connect with the global community of experts working for the implementation of the Basel III framework, to gain insight into the G20 efforts to regulate the global financial system, to explore new career avenues, and most of all, to acquire lifelong skills.

You can explore what we offer to our members:

1. Membership - Become a standard, premium or lifetime member.
You may visit:
https://www.basel-iii-association.com/How_to_become_member.htm

2. Monthly Updates – Visit the Reading Room of the association at:
https://www.basel-iii-association.com/Reading_Room.html

3. Training and Certification – You may visit:
https://www.basel-iii-association.com/Basel_III_Distance_Learning_Online_Certification.html

For instructor-led training, you may contact us. We tailor Basel III presentations, awareness and training programs for supervisors, boards of directors, service providers and consultants.