THE CHAIR

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To G20 Finance Ministers and Central Bank Governors

We gather at an important time for the global financial system. An improving inflation outlook has seen a number of central banks cutting interest rates in recent months. While these moves may gradually ease interest burdens on households, firms and governments, modest global growth and historically elevated debt levels mean that many borrowers remain vulnerable to adverse shocks.

Against this backdrop, the longstanding financial system vulnerabilities discussed in my July letter require our ongoing attention. The short-lived market volatility in August illustrates a number of these vulnerabilities related to elevated asset valuations, the interaction of non-bank liquidity and leverage, and interlinkages between asset markets and funding markets. It's important to maintain momentum in addressing them.

Meanwhile, the role of technology in the financial system is growing, leading to new interconnections and dependencies. The FSB recognises the transformative potential of digital technologies to enhance financial services, improve access and efficiency, and reduce costs globally. But increasing digitalisation also presents risks and means that shocks can propagate more rapidly across sectors and borders.

The FSB is committed to developing a robust framework to harness the opportunities from digitalisation while mitigating associated risks, which supports Brazil's G20 Presidency goal of building a just world and sustainable planet. This letter outlines the work we are delivering to the October meeting of the G20 Finance Ministers and Central Bank Governors, all of which contributes to this framework.

Harnessing the benefits and responding to the challenges of technological innovation

Cross-border payments

Financial innovation has delivered substantial advancements in the efficiency of payments, such as the development and interlinking of fast payment systems. Harnessing these innovations is essential if we are to achieve the G20 Roadmap goals of cheaper, faster, and more transparent and inclusive cross-border payments.

The FSB closely monitors efforts to advance and complete the Roadmap's priority actions. We are delivering to this meeting the G20 Roadmap Progress Report, which highlights advances in harmonising data requirements, extending operating hours, and interlinking fast payment systems. This year also saw good progress in addressing frictions arising from the rules, laws and regulatory requirements for collecting, storing and managing data for cross-border payments, as well as from the uneven playing field resulting from the inconsistent supervision and regulation of banks and non-banks. Implementing the recommendations will be a key focus for FSB members in 2025.

However, much more work is needed to achieve the ambitious targets set by the G20 for 2027, as illustrated by our report on Key Performance Indicators (KPIs), developed to monitor progress. At the global level, the KPIs showed limited progress toward achieving the targets. Some regions continued to face greater challenges, particularly in meeting the targets set for cost and speed. While it will take time for some of the priority actions to translate into tangible outcomes, there is no room for complacency. In 2025, a key focus will be on implementation of the necessary changes by payment service providers, operators, and policy makers in individual jurisdictions. In light of the significant benefits that enhanced cross border payments can deliver globally, the FSB and partner organisations will continue to monitor progress and will evaluate whether further steps (by the public and private sectors) might be required to achieve the targets.

Lessons learnt from the March 2023 banking turmoil

A rapid increase in interest rates during 2022-23 exposed vulnerabilities in a weak tail of banks, culminating in the March 2023 banking turmoil. This episode also illustrated the role that technological advancements can play in accelerating the propagation of shocks. In light of this, our report on the lessons from the March 2023 banking turmoil investigates the role of technology, social media, and interest rates on depositor behaviour and deposit 'stickiness'.

The report finds that technological advancements have facilitated an easier and faster transfer of deposits in recent years, which can contribute to the speed of deposit runs. There is also some evidence that social media has the potential to facilitate or accelerate deposit runs through the propagation of information, including disinformation and rumours. Looking ahead, deposits could become even less 'sticky' should the adoption of artificial intelligence, tokenisation and digital wallets increase further. It is therefore important for bank managers and financial authorities to be able to react more quickly to deposit outflows than in the past. Our report highlights the need to monitor liquidity-related vulnerabilities, adjust liquidity risk management practices and liquidity supervision, ensure existing central bank facilities can be accessed quickly when needed, and enhance the ability of authorities to plan for and execute a resolution in a fast-fail scenario.

The report also scans the financial system to identify types of entities – such as a weak tail of banks, life insurers, and non-bank real estate investors – that are most vulnerable to the interest rate and liquidity risks at this juncture. Further work to assess vulnerabilities in these entity types is being undertaken by the FSB and relevant standard-setting bodies (SSBs).

Cyber and operational resilience

Cyber and operational risks remain a significant threat to financial stability. The interconnectedness of the global financial system means that an incident at one institution, or even one arising from outside the financial system, can have far-reaching implications. These risks were illustrated by the CrowdStrike outage and by operational disruptions in high-value messaging and payments systems in July. Whilst the quick resolution of these incidents meant they did not compromise financial stability, there were impacts to the ability of many financial institutions to carry out their core business. This highlights the importance of managing concentration and dependencies within the supply chain, baselining and testing against a range of severe but plausible scenarios, and enhancing individual and collective capabilities to respond to, and recover from, disruptive events manifesting concurrently across geographies and sectors.

Efficient and effective response to and recovery from operational incidents are essential to limiting related financial stability risks. To facilitate this, the FSB is delivering, for public consultation, a common Format for Incident Reporting Exchange (FIRE). FIRE aims to promote greater convergence in incident reporting, address operational challenges arising from reporting to multiple authorities and foster better communication amongst authorities. It is designed to cover operational incidents, including cyber incidents, and extends beyond the FSB's previous work on cyber resilience. After public consultation, we expect to publish the final version of FIRE by Q2 2025.

Crypto-assets

Since the G20's endorsement of the FSB's global regulatory framework for crypto-assets in July 2023, the FSB and International Monetary Fund (IMF) have worked together to promote and support its effective implementation. Our status report, prepared at the request of the Brazilian G20 Presidency, outlines the progress made by jurisdictions in implementing the policy and regulatory responses developed by the IMF, FSB, and SSBs.

Much progress has been made since the publication of the FSB's recommendations, as nearly all FSB member jurisdictions are currently developing or already have in place a regulatory framework applicable to at least part of crypto-asset activities. However, the report flags some challenges. First, the reality is that globally many crypto-asset issuers and service providers are still operating without being subject to comprehensive regulation or in non-compliance with applicable jurisdictional regulations. Second, cross-border crypto-asset activities originating from offshore jurisdictions present elevated regulatory and supervisory challenges for authorities. This is because inconsistent implementation of the FSB Framework internationally could hinder its effectiveness and may lead to regulatory arbitrage and challenges for cross-border enforcement. Finally, further progress is required to ensure that stablecoins are subject to the specific regulatory requirements needed to address their vulnerability to a sudden loss of confidence and potential runs on the issuer or underlying reserve assets.

This is all set against the backdrop of increasing interlinkages between crypto-asset markets and core financial markets. Thus, to contain potential risks to the international financial system, it is essential to advance the implementation of the FSB's global regulatory framework for crypto-assets, both within and beyond the G20. The FSB and IMF, together with the SSBs and other international organisations, will continue to support and facilitate the implementation of this framework.

Tokenisation

Another manifestation of technological change is the growing use of distributed ledger technology (DLT) to issue or represent assets in digital forms known as tokens. Tokenisation of assets may have the potential to improve efficiencies and provide access to new markets for investors, but it can also amplify many of the same vulnerabilities seen in traditional finance. For example, the choice of settlement assets may affect liquidity vulnerabilities; some of the entities involved in tokenisation may not be compliant with applicable laws and regulations or fall outside of the regulatory remit; and DLT is an evolving technology that is relatively untested.

The limited publicly available data on tokenisation suggests that its adoption is still very low, so it does not currently pose financial stability concerns. However, tokenisation could have implications for financial stability if it scales up significantly, if it is used to create complex and opaque products that trade in an automated fashion, and if identified vulnerabilities are not adequately addressed through oversight, regulation, supervision, and enforcement. Our report on the financial stability implications of tokenisation outlines issues that authorities and international bodies should consider: i) address data gaps in monitoring tokenisation adoption; ii) increase understanding of how its features fit into legal and regulatory frameworks and supervisory approaches; and iii) facilitate cross-border information sharing.

Conclusion

Rapid technological change is reshaping many areas of finance. It is important that financial authorities keep up with this change in their oversight, regulatory, and supervisory activities.

International work has been underway to develop common standards in areas like cross-border payments and operational risk. However, the work does not end once the standards have been developed. Effective and timely implementation is critical. The FSB will continue to support the implementation of agreed policies and to facilitate cross-border cooperation in the interest of global financial stability.

But we cannot do it alone. Leadership from the G20 is necessary to energise the public and private sectors and provide the political impetus for implementation of our policies, without which change will not happen. After all, financial stability is a prerequisite for achievement of the G20's socio-economic goals.

Yours sincerely,

Klaas Knot