January 20th, 2022

Klaas Knot
President, De Nederlandsche Bank
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INSTITUTE OF INTERNATIONAL FINANCE

Dear President Knot:

It was great seeing you in Washington, D.C. last October and I appreciate you taking the time to speak at our 2021 Institute of International Finance (IIF) Annual Membership Meeting. At the time, I congratulated you in advance as you were soon to become Chairman of the Financial Stability Board (FSB). Today, I thought we could give you some of our thoughts as you settle into this vital role.

The FSB is critical to the coordination of national authorities and international standard-setters to promote the overall stability of the global financial system. Given your extensive experience, we at the IIF have every confidence that the FSB will continue to flourish under your leadership.[1]

Since the onset of the COVID-19 pandemic, the FSB has played an especially important role in coordinating and encouraging policymakers across the world to act swiftly, proactively, and consistently to shore up their economies and financial systems. This has been complemented by a robust collaboration between the regulatory community and the financial industry to help mitigate the economic fallout from the crisis and ensuring that the financial sector continues to support its clients and the global economy.

We welcomed the FSB evaluation report *Lessons Learnt from the COVID-19 Pandemic from a Financial Stability Perspective* and the identification of important areas for further work and analysis.[2] This evaluation work is taking place alongside similar work by the Basel Committee on Banking Supervision (BCBS). However, as we move forward with implementation of Basel III and other regulatory requirements, it will be important that the FSB takes an active coordination role, working with fellow regulators and the industry to address the issues exposed during the pandemic. This will help to ensure a coherent, appropriately calibrated and globally consistent regulatory landscape.

Since the inception of the FSB (and its predecessor, the Financial Stability Forum), the IIF has been a supportive and active contributor to its activities by representing the global financial industry. Therefore, I would like to highlight some priority topics where the IIF believes the FSB can play a key role going forward in promoting effective and pragmatic common global standards and overall leadership. (We have included an Appendix with more details on these areas.)

- **Market fragmentation:** The FSB launched an initiative in 2018 to explore ways to address the risk of market fragmentation.[3] This work, conducted in coordination with the International Organization of Securities Commissions (IOSCO), is critical as fragmentation resulting from excessive regulatory and supervisory divergence can trap capital, liquidity, and risk in local markets, create significant financial and operational inefficiencies resulting in additional

[1] The Institute of International Finance is the global association of the financial industry, with more than 400 members from more than 70 countries. Its mission is to support the financial industry in the prudent management of risks; to develop sound industry practices; and to advocate for regulatory, financial, and economic policies that are in the broad interests of its members and foster global financial stability and sustainable economic growth. IIF members include commercial and investment banks, asset managers, insurance companies, sovereign wealth funds, hedge funds, central banks, and development banks. For more information see www.iif.com.

[2] FSB 2021. "Lessons learnt from the COVID-19 pandemic from a financial stability perspective: Interim report" July 13, 2021.

[3] FSB 2018. "FSB reviews financial vulnerabilities and deliverables for G20 Summit" Oct. 22, 2018.

unnecessary costs to end-users, and reduce the capacity of financial firms to serve both domestic and international customers.

- **Non-bank financial intermediation:** The IIF commends the work to date on the initiatives of the FSB and other global standard-setters for the NBFI sector. The IIF recognizes that money market fund (MMF) market and product structure differences may make it difficult to implement fully harmonized global standards for MMFs. However, it may be possible to achieve some level of harmonization with respect to reforms that address issues that are similar across jurisdictions (e.g., the decoupling of regulatory thresholds and redemption fees) and in adopting some common terminology with the goal of facilitating a common language among regulators and market participants.

- **Digital currencies, stablecoins and cross-border payments:** The IIF looks forward to continuing our close engagement with the FSB, the Committee on Payments and Market Infrastructures (CPMI) and other global and regional standard-setters as we embrace the digital transformation of money and payments. We strongly believe in the potential of digital currency and digital identity to deliver efficiencies and welcome the continuing focus of the FSB on topics such as global stablecoins and the G20's cross-border payments roadmap. We will continue to highlight a spectrum of technology driven solutions that the financial services industry is developing to deliver faster, lower-cost, and more transparent payments around the world. Going forward, more will also need to be done to identify and address the implications of developments arising across the digital assets spectrum, to include Central Bank Digital Currency (CBDCs), stablecoins and other crypto-assets. This must include the development of an appropriate monitoring framework for such assets, and it is important that private-sector efforts not be crowded out or foreclosed by precipitate official sector activity.

- **Climate change and sustainable finance:** Given the global nature of the climate change agenda, global leadership is essential to encourage the development of well-aligned and considered regulatory and supervisory approaches across jurisdictions. Towards that end, the FSB's multi-year Roadmap for Addressing Climate-related Financial Risks is a comprehensive overview of many of the priority areas for both the global standard-setting bodies and the financial services industry.[4] The IIF has worked with our global membership to advance thought leadership on these topics, including disclosure, data and methodologies, climate risk and climate scenario analysis, as well as regulatory and supervisory approaches.

- **Cyber risk and operational resilience:** As the number, scope, and sophistication of cyber-attacks continue to increase it is important that the FSB and global standard-setters encourage and work closely with regional national authorities to coordinate cyber incident reporting practices, in addition to clarifying definitions. The increased use of public-private platforms and enhanced information-sharing practices can also support a stronger financial ecosystem. A related area is operational resilience, which is highly important to both public sector authorities and financial institutions and has come into focus during the COVID-19 pandemic. While the BCBS has taken the lead in developing principles for the banking sector, it is important that similar approaches by CPMI, the International Association of Insurance Supervisors (IAIS), and IOSCO are consistent and coordinated, to prevent fragmentation and ensure consistency across the financial ecosystem.

We very much look forward to working with you and with the FSB on the priority topics laid out above, and I wish you much success in your new role. I would appreciate an opportunity to meet with you when

[4] FSB 2021. "FSB roadmap for addressing climate-related financial risks" July 7, 2021

I’m next in Amsterdam to discuss in more detail these views which are presented in the spirit of strengthening and reinforcing the role of the important institution that you now lead.

Very truly yours,

Timothy D. Adams

CC: Dietrich Domanski, Secretary General, Financial Stability Board

APPENDIX

IIF Feedback on Financial Stability Board (FSB) Priority Topics

Below are priority topics where the Institute of International Finance (IIF) believes there is a unique opportunity for the FSB to play a key role going forward in promoting effective and pragmatic common global standards, and in fostering consistency and collaboration among global standard-setting bodies and member jurisdictions.

Addressing market fragmentation: We strongly support the work that the FSB launched in 2019 to explore ways to address the risk of market fragmentation: exploring what market fragmentation is; under what conditions it can emerge; and what its potential impacts are. Common and consistent global rules support cross-border investment and economic activity by enabling financial institutions and markets to maintain international funding flows and provide key services to support a globalized economy. To support the FSB's work program, the IIF published a report on "Addressing Market Fragmentation: The Need for Enhanced Global Regulatory Cooperation."[5] The report analyzed the risks and negative consequences of regulatory fragmentation and described various types of regulatory fragmentation with current examples of where this problem is more acute. The report described many sources of fragmentation (e.g., diverging standards, local supervisory measures and ring-fencing, extra-territoriality; and obstacles to cross-border cooperation and information sharing). The IIF report also outlined several measures that could be considered to help promote a level playing field and reduce opportunities for regulatory arbitrage, including specific measures to address regulatory fragmentation and ways to enhance international cooperation among authorities. This was followed by an IIF paper on The Value of Cross-Border Banking and the Cost of Fragmentation that evaluates the benefits as well as the associated risks of cross-border banking, with a focus on its implications for the macroeconomy and financial stability.[6]

The FSB has identified four areas of market fragmentation that it wants to address, in collaboration with other standard-setting bodies: enhancing the clarity of deference processes in derivatives markets; strengthening the understanding of approaches by supervisory and resolution authorities towards pre-positioning of capital and liquidity by international banks; considering ways to enhance supervisory communication and information sharing, including approaches and mechanisms to avoid future fragmentation; and considering whether there is evidence of market fragmentation with observed consequences for financial stability as part of the FSB's ongoing evaluation of the effects of too-big-to-fail reforms.[7]

But the reality is that market fragmentation continues to pose a challenge to the financial system, in areas including local supervisory measures and ring-fencing (restrictions on third country branches, internal TLAC, operational fragmentation), diverging standards and approaches (Basel III implementation, derivatives trading, timing and scope issues, benchmarks), extraterritoriality (derivatives, proprietary trading, markets in financial instruments), and obstacles to cross-border cooperation and information sharing (data localization, cyber security, operational resilience, AML/CFT.) Therefore, further efforts by the FSB and global standard-setters to address fragmentation should be supported and further enhanced. As the negative effects of market fragmentation become increasingly evident – also as economies recover from the COVID-19 pandemic at different speeds – urgent coordinated action should be pursued. Simultaneously, consideration of specific practical measures to prevent fragmentation (by enhancing regulatory and supervisory cooperation) and to correct its negative effects should be developed. The IIF welcomes the opportunity to continue to collaborate in this process.

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[5] IIF 2019. "Addressing Market Fragmentation: The Need for Enhanced Global Regulatory Cooperation" Jan. 24, 2019.
[6] IIF 2019. "The Value of Cross-Border Banking and the Cost of Fragmentation" Nov. 13, 2019.
[7] FSB 2019. "FSB Report on Market Fragmentation" June 4, 2019.

Non-bank financial intermediation: As the FSB has noted in its recent publications and consultations, the NBFI sector is an increasingly important component of the larger financial services sector and, as such, the financial stability of non-bank financial market participants is an important issue for the FSB agenda. A wide range of investors rely on non-bank financial intermediaries, particularly money market funds, as an important part of their investment portfolios. Given the critical role of these funds, the FSB should encourage sectoral standard-setters, such as IOSCO, to apply targeted and proportionate measures that do not have the effect of limiting or shrinking these markets. As detailed in our letter to the FSB Technical Expert Group on Money Market Funds, we commend the work to date on the initiatives of the FSB and other global standard setters for the NBFI sector.[8] These efforts have contributed significantly to the mitigation of risks identified in the Great Financial Crisis and to the resilience of MMFs and short-term funding markets (STFMs). We believe that the March 2020 market disruptions stemmed to a considerable extent from the fact that these markets became one-way markets and short-term market liquidity was severely constrained

Given important differences in market and product structure and market specificities across jurisdictions, it may be difficult to implement fully harmonized global standards for money market funds and short-term funding markets. However, to address regulatory and market fragmentation concerns, we encourage the FSB to explore with sectoral standard-setters the scope for adopting some common terminology with the goal of facilitating a common language among regulators and market participants. It may also be possible to achieve some level of harmonization in respect of reforms that address issues that are similar across jurisdictions, such as the decoupling of regulatory thresholds and redemption fees, an option that the IIF supports.

We appreciate and share the FSB's interest in broader NBFI issues, including margining practices, open-end funds, and U.S. dollar funding dependencies. In addressing these broader issues, the IIF reiterates its call for proportionate and targeted measures that are carefully designed to address the underlying causes of market instability and for solutions that minimize the risks of regulatory and market fragmentation, recognizing that some differences in treatment across jurisdictions may be unavoidable to reflect national and regional market characteristics. We look forward to continuing our active engagement and dialogue with the FSB, other global standard-setters and the regulatory community on these matters of mutual interest.

We also appreciate that the insurance industry is an important focus of the FSB's work, as the industry plays an integral role in the overall financial services sector and the broader real economy. The global insurance industry contributes to financial stability at global and national levels by providing liquidity and insurance cover for key risks, which have expanded in scope in recent years. One of those key risks is cyber risk. The IIF has been analyzing cyber risk and resilience and the cyber insurance market since 2018. This work has included developing with our members sound practices for mitigating cyber risk as well as operational risk more broadly. A second key risk is climate risk. The IIF has for several years worked with its insurance members to raise awareness of, and to develop best practices, for the assessment and mitigation of physical and transition climate risks. The unprecedented nature of climate-related risks impacts both sides of the insurance balance sheet and presents unique challenges that require a strategic response by the industry.

Digital currencies, stablecoins and cross-border payments: The IIF has been working in active partnership with the FSB, CPMI and the official sector across an ambitious agenda relating to digital currencies, stablecoins and cross-border payments. In the past year, the IIF has contributed to the FSB's consultations on global stablecoin arrangements, on third party arrangements including cloud, and on targets for the G20 cross-border payments roadmap. We are currently finalizing submissions to the FSB on data barriers

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[8] IIF 2021. "IIF Comments on FSB Consultation Report on MMF Policy Proposals" Aug. 16, 2021.

to cross-border payments and to CPMI on possible extensions of real-time gross settlement operating hours. In November we were pleased to host a virtual roundtable with CPMI and IOSCO on Principles for Financial Market Infrastructures and stablecoins. We look forward to continuing this fruitful engagement under your leadership.

We have co-convened the Global Payments Forum, designed as a key engagement mechanism with the FSB, CPMI and other standard-setting bodies responsible for the design and delivery of the cross-border payments roadmap, and will be looking for ways to provide efficient and valuable engagement going forward. We have also brought our members to work together with other industry experts on foundational issues such as digital identity and verifiable credentials through the Open Digital Trust Initiative. We continue to keenly monitor developments in CBDC and stablecoins, as well as publications and speeches emanating from the Bank for International Settlements and the Financial Stability Institute on bigtech in finance. We welcome the focus on bigtech in finance, while cautioning against actions that would reduce the predictability of the overall regulatory environment or would result in "data protectionism" or data barriers at a time when cloud computing is helping to transform the convenience, security and efficiency of cross border payments for individuals and businesses.

Climate change and sustainable finance: The IIF is working with our members on all areas of sustainable finance, including disclosure; Environmental, Social, and Governance (ESG) data and ratings; classification instruments; climate scenario analysis; regulatory and supervisory approaches; and net-zero commitments and transition plans. We are engaging with the FSB and global standard-setting bodies by responding to consultations on behalf of our membership and by sharing analytical reports, such as those published in 2021 on prudential approaches[9] and climate scenario analysis.[10]

In the IIF's *Prudential Pathways* report we communicated global industry views on the rapidly evolving set of supervisory and regulatory approaches to climate-related and environmental risks facing the banking and insurance sectors. In the report, we have proposed that prudential authorities consider both the microprudential objective of resilience and the macroprudential objective of examining the alignment of the financial system with future climate pathways, with a view to reducing the potential for financial instability stemming from climate-related or environmental risks. However, we caution against going further to pursue an "active transition" objective – the use prudential tools to regulate and incentivize the financial system to actively steer the low-carbon transition of key sectors in the real economy, via the provision and pricing of financial products and services. More generally, it is important that prudential authorities coordinate approaches to reduce market fragmentation, support, and leverage market-based solutions, and take a data-driven and rigorous analytical approach in their response to climate and broader ESG risks and opportunities. Further, it is important that financial sector authorities take a proportionate and sequential approach to considering these topics in their work programs.

The IIF's *Navigating Climate Headwinds* report was developed in close collaboration with a group of 20 large global banks to take stock of industry and supervisory work on scenario-based climate risk measurement. The report includes proposals to guide greater global alignment and collaborative development on this important topic, and includes recommendations for the global industry, the FSB, global standard-setters, and jurisdictional prudential authorities on how to move forward. For example, some important recommendations include calling for a clear distinction between 'climate scenario analysis' and 'climate stress testing' and cautioning against using the results of scenario-based climate risk measurement exercises to inform capital requirements. More broadly, during the current developmental phase for such exercises, there are practical and conceptual benefits to differentiating them from other

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[9] IIF 2021. "Prudential Pathways: Industry Perspectives on Supervisory and Regulatory Approaches to Climate-Related and Environmental Risks" Jan. 21, 2021.

[10] IIF 2021. "Navigating Climate Headwinds: Reference Approaches for Scenario-based Climate Risk Measurement by Banks and Supervisors" July 15, 2021.

prudential activities, including macro-financial stress testing. In the spirit of using supervisory exercises to date to learn and build capacity, we welcome the FSB's plans to collaborate with the Network for Greening the Financial System (NGFS) in 2022 to publish a joint report synthesizing outputs of analysis done by jurisdictions so far on the implications of possible future climate scenarios for the financial system

In 2022, the IIF will continue its thought leadership and proactive engagement with the global standard-setting bodies on key topics such as the development by the newly formed International Sustainability Standards Board (ISSB) of international sustainability disclosure standards, the evolution of data and tools such as climate scenario analysis, and emerging prudential approaches. We look forward to engaging with the FSB on these topics and are always willing to convene our global membership to advance public-collaboration in this area.

Climate disclosure has also been identified as an area for further work by the IAIS and the IIF works with its insurance members to support improved decision-useful climate disclosures. We also support the work of the IAIS in collecting and analyzing data on climate-related risks in its Global Monitoring Exercise and in developing a stock-take on climate scenario analysis exercises among insurance supervisors. The IIF is planning a stock-take exercise on climate scenario analysis among its insurance members and the IAIS leadership has expressed interest in collaborating with the IIF on climate scenario analyses for insurers. We are hopeful that this collaboration will help to facilitate harmonized approaches to supervisory engagement on climate-related risks.

Cyber risk and operational resilience: When it comes to cyber security, the FSB has played a central role in helping to highlight and address market fragmentation across jurisdictions. The FSB "stocktake" on cybersecurity regulations, guidance and supervisory practice published in October 2017, found a divergence of practices being introduced around the world. Notably, the report concluded that the FSB's 25-member jurisdictions had 85 different schemes of regulation and guidance, and 35 different supervisory practices.[11] The Cyber Lexicon, published a year later, defines 50 core terms to cyber security and cyber resilience, helping promote consistency internationally.[12] Then, the recent publication of Effective Practices for Cyber Incident Response and Recovery, provides a toolkit of effective practices for cyber incident response and recovery.[13] All these initiatives have helped streamline public sector initiatives and private sector approaches to cyber resilience.

Fragmentation of cyber security regulations and practices remains a considerable concern to the financial services industry, especially for firms that operate in multiple jurisdictions. Complying with myriad regulations and guidelines is complex, costly and diverts resources away from other effective cybersecurity related activities. Rather than enhancing overall cyber-resilience, uncoordinated policies, guidelines, and regulations can pose a risk to financial stability, especially when testing critical systems multiple times or creating unnecessary duplication of sensitive information. Collecting relevant and accurate information on cyber incident reporting, and sharing it with peers and authorities, is crucial to supporting cyber resilience and financial stability across the financial industry. It is important that global standard-setters, including the FSB, encourage and work closely with regional national authorities to coordinate cyber incident reporting practices, in addition to clarifying definitions and creating a common taxonomy. The FSB could also provide leadership in supporting greater usage of public-private platforms and enhanced information-sharing practices to further strengthen the financial ecosystem.

A related but distinct area is operational resilience, which is critical for the public and private sectors to maintain confidence in the financial industry and support financial stability and economic growth. The

[11] FSB 2017. "Summary Report on Financial Sector Cybersecurity Regulations, Guidance and Supervisory Practices" Oct. 13, 2017.
[12] FSB 2018. "Cyber Lexicon" Nov. 12, 2018.
[13] FSB 2020. "Effective Practices for Cyber Incident Response and Recovery: Final Report" Oct. 19, 2020.

Basel Committee has promoted a principles-based approach to improving operational resilience for the banking sector.[14] While that is already important work, the IIF and our members recognize the importance of operational resilience for individual institutions, and across the entire financial sector, in support of customers, markets and the communities and broader economies they support nationally and globally. As CPMI, IAIS and IOSCO begin developing their own approaches to operational resilience, the FSB can play an important role to promote cross-sectoral consistency, coordination, and collaboration both between jurisdictions and across the wider financial system as a whole. The FSB's work on third parties and outsourcing also very much complements these efforts.

[14] BCBS 2021. "Principles for operational resilience" March 31, 2021.