Strengthening Financial Regulation:

The Role of the Financial Stability Board

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Since their first summit in Washington in 2008, the G20 leaders have placed financial regulation at the centre of their agenda, along with macroeconomic policy coordination and reform of the international financial architecture. On financial regulation, one of the G20's main tasks is to provide the Financial Stability Board (FSB) with sufficient political will and momentum to carry out global reform.

The FSB is leading a group of international standard-setting bodies, including the Basel Committee on Banking Supervision, the International Organization of Securities Commissions, the International Association of Insurance Supervisors and the Committee for Payment and Settlement Systems. Together, they will monitor the implementation of Basel 3, regulate shadow banking, address the 'too big to fail' problem, develop a global system for legal entity identifiers and complete reforms of over-the-counter (OTC) derivatives.

The FSB itself is being transformed into a full-fledged international organisation. In January2013,at its plenary meeting it took steps to constitute itself as a legal entity and indeed was established as an association under Swiss law. This is an important step in the implementation of the recommendations endorsed by G20 leaders at the 2012 Los Cabos Summit for placing the FSB on an enduring organisational footing, as a legal entity with strengthened governance, greater financial autonomy and enhanced capacity to coordinate the development and implementation of financial regulatory policies.

What is the relationship between G20 and the FSB? What is the division of labour between these two bodies? How does the G20 push the institutionalisation of the FSB? The process is a contradictory but also complementary one. The G20 keeps its informality, while it propels the formalisation of the FSB.

The institutionalisation of the FSB

The predecessor of the FSB was Financial Stability Forum. It was founded in 1999 by the G7 finance ministers and central bank governors. It was a typically informal institution, without a legally binding charter, with only developed countries as members. At their first G20 summit, the leaders noted the huge deficit of representativeness and suggested emerging economies be included. In March 2009the Financial Stability Forum expanded to include all the emerging economies in the G20, but it remained an informal institution. The next month, at the London Summit, the G20 leaders established the new FSB to succeed the Financial Stability Forum. The FSB would help the G20 implement the new financial regulatory rules. At the G20 Pittsburgh Summit in September 2009, the leaders agreed to set up the FSB charter, which included the mandate, organisational structure and working practices of the new international organisation. This indicated the desire of the G20 leaders to formalise the institution.

Generally, formalisation includes three dimensions: obligation, precision and delegation. Obligation means that the institution is legally bound by rules or commitments and therefore subject to the general rules and procedures of international agreements. Precision means that the rules are definite, unambiguously defining the conduct they require, authorise or proscribe. Delegation grants authority to third parties for the implementation of rules, including their interpretation and application, dispute settlement and possibly further rulemaking.

On obligation, in the case of countries, one requirement is to participate in a financial sector assessment programme (FSAP)every five years and to publicise the detailed assessments produced by the International Monetary Fund and the World Bank and used as a basis for their reports on the observance of standards and codes (ROSCs). A second is to implement international financial standards, including new standards created by the FSB. On precision, besides participating in FSAPs, FSB members undergo two kinds of peer review: a thematic review and a country review. If the FSAP could be considered a comprehensive test, then the thematic and country reviews are specific tests. The FSB will publish the much more precise compliance report, along with a designation of fully qualified, basically qualified, basically unqualified or fully unqualified entities. On delegation, unlike the Financial Stability Forum, the FSB has its own secretariat, which plays an important role in setting the agenda and implementing the requirements. And the FSB has its plenary meeting and steering committee, as well as standing committees on assessment of vulnerabilities, standards implementation, supervisory and regulatory cooperation, and budget and resources, and several regional consultative groups.

The FSB is thus already more formalised than its predecessor. Within the G20 framework, the FSB is the only formal international organisation that helps to implement the G20 leaders' commitments on financial regulation.

Tasks and challenges facing the FSB

Has the FSB gone far enough or too far? The answer depends on the tasks and challenges facing it. In St Petersburg, the G20 and FSB have much work to do on financial regulation, mainly in promoting compliance with Basel 3, strengthening regulations of shadow banking, developing the 'too big to fail' regulatory framework for the global systemically important financial institutions, and addressing the outstanding cross-border inconsistencies, especially in OTC derivative markets. This work can be divided into two categories: implementing existing rules and making new ones.

The first task for the FSB is to promote implementation and compliance with existing international financial standards. For its members, the FSAP process and publication of ROSCs can improve compliance levels. For non-members, the FSB has told a list of non-cooperative jurisdictions that non-compliance could be met with measures such as publishing their names. Although such a blacklist carries no formal legal sanctions, the FSB recommends that financial institutions in all countries should impose high levels of scrutiny on transactions going to, from or through blacklisted jurisdictions. In this sense, blacklisting is a form of power that creates a negative status for those institutions on the list. In turn, this negative status is widely linked with material costs in terms of disinvestment. So peer review and blacklisting may be important mechanisms for monitoring and encouraging compliance with FSB requirements.

However, the FSB also faces big challenges. Technically, the FSB's secretariat is very small. It is difficult for FSB to perform big tasks such as conducting extensive peer reviews. Politically, developing countries — especially those not members of the FSB –may resist such a coercion. The costs of implementation for developing countries also raise concerns.

Another task for the FSB is setting new international financial standards. Before the financial crisis, Anglo-American practices acted as a kind of focal point for international financial coordination because of their prestige and apparent success. Since the financial crisis, these practices have lost some of their legitimacy, and it is increasingly difficult to set international financial regulations. Some emerging countries hold very different opinions towards financial regulation. For example, China and India consider domestic financial regulation more important, although international financial regulation is necessary. The FSB should thus work towards more information sharing, research collaboration and capacity building.

Conclusion

Compared to other G20 agenda like macroeconomic policy coordination and international financial architecture reform, financial regulation is more technical and likely to have incremental progress in the post crisis era. FSB is the first international institutional innovation of the G20, and its achievements represent G20 leaders' contribution in the development of global economic governance.