Sir Jon Cunliffe

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Concluding remarks

Thank you very much, David. Thank you for inviting me to speak today. I certainly hope I will be able to attend Eurofi in person physically soon. I will say a word about Brexit but it will just be a word.

I wanted to talk this evening about three particular questions. The first one is: what have we learned about cooperation and fragmentation in the financial system over the stresses of the last year? The second question is: what lessons might other non-financial sectors draw from the post-financial crisis performance of financial regulators and supervisors who have been implementing it over the last 10 years? The third question is: what might be the impact on the financial sector of some of the fragmentation dynamics which have been generated by the Covid crisis?

Looking first at the financial system under Covid, my high-level conclusion is that where we have put in place robust global frameworks the financial system has, so far, proved resilient to an extreme tail event. What I have in mind here is primarily the banking system that was at the epicentre of the financial crisis 10 years ago. Internationally agreed standards for capital and liquidity have enabled the banking system to meet the initial surge of borrowing as the implications of the pandemic became clear a year ago, then to maintain lending - supported in most jurisdictions by government schemes - and finally also to weather the prospect of material losses as a result of the economic impact of the pandemic.

We are not out of the woods yet. Huge fiscal support to corporates and households in many countries has meant that the losses from the crisis have not yet crystallised. We will only really see the true extent as the pandemic recedes, as public support is withdrawn and as the scale of the economic damage is revealed. There are longer-term questions about the usability of capital and liquidity buffers in the recovery and perhaps the biggest test may yet be to come. However, solvency itself has not been a worry. 10 years ago the very prospect of losses from an economic hit of this magnitude would have meant failing banks and a financial crisis. By contrast, as a result of the post-crisis reforms, confidence in the core banking system has been maintained.

The same, unfortunately, is less true of non-bank finance where the prospect of economic damage from the pandemic led in March to a dash for cash that disrupted core financial markets and tightened financial conditions at exactly the wrong time. It required massive intervention by central banks to restore order and to stabilise non-bank finance. It is of course to be expected that the sudden arrival of a pandemic will cause financial sector stress and a very sharp adjustment in financial markets.

However, there also appears to have been a number of factors that amplified that stress and created a self-reinforcing liquidity crisis that could only be stopped by central bank intervention. With one notable exception, namely the run-on money market funds, these dynamics were quite different from those that we saw in the financial crisis 10 years ago. This may have been the result of reinforcing the resilience of some core parts of the system, wholesale banking and central clearing, for example, perhaps without sufficient attention to the resilience of the non-bank entities that interact with the core. The international regulatory community, through the Financial Stability Board and the standard-setting bodies, now have a major programme and will work hand-in-hand to investigate those dynamics and vulnerabilities and to develop policy responses where justified.

That brings me to another very important takeaway from the very real stress test that the financial system has experienced over the past year: the way in which the machinery for international regulatory cooperation has functioned. Strengthening this machinery with the creation of the FSB was one of the key reforms of the global financial crisis. Over the past year the FSB and the standard-setting bodies have worked extensively and effectively to assess risk, share experience and coordinate action. Individual jurisdictions, of course, have tailored their regulatory actions in the fact of the pandemic to meet individual circumstances, but there has been broad agreement of consistency in the approach to temporary regulatory flexibility and forbearance. That has been underpinned throughout by the principles agreed at the beginning of the crisis by the FSB to enable a coordinated response while minimising the risk of market or regulatory fragmentation.

Unlike many of the structures for international cooperation and coordination in other sectors, structures that have been weakened in recent years, in the financial sector the machinery put in place 10 years ago has so far responded well to its first major stress. However, again, we have not come to the end of the story. One important next test will be whether we can come to an agreement internationally on how - and how far - to reinforce the resilience of non-bank finance and whether we can implement any changes.

That brings me to my second question: is there anything that other, non-financial, sectors could learn from the experience of the financial system over the past year? I should stress here that I am not claiming some higher wisdom or nobler purpose on the part of financial sector regulators and central bankers. The reforms have made the financial sector more robust and have enabled the authorities to work together with the result of a searing global and financial economic crisis that may have done longer lasting damage to the world economy than Covid is likely to do. It is rather that lessons learned very painfully in one area may offer some pointers to those dealing with similar issues in other areas. The overarching lesson is that, 10 years ago, we came through crisis to what appears to be a similar fork in the road. Financial globalisation had been one of the drivers of growth in the global economy and the lifting of hundreds of millions out of poverty but it also contributed to a series of crises, first regional and finally global, amplifying adverse risks and shocks and transmitting them between jurisdictions.

The choice, put very starkly, was between fragmentation - putting up barriers to cross-border flows of capital and financial services generally with all costs in terms of reduced risk sharing and lost efficiency that brings - and governance - putting those global flows onto a safer, more resilient, more managed and internationally agreed and trusted footing. The consensus was in very large part for the governance approach. The international regulatory community, with powerful political support from the G20, launched an unprecedented programme overseen by a new institution to put in place the necessary international standards and cooperation mechanisms. Some have portrayed this as a way of resolving the tension between the economic benefits of financial globalisation on the one hand and the danger of that globalisation posed for individual jurisdictions through the importing of risks to their financial stability on the other hand. That logic was certainly one of the drivers of what I have called the international governance approach. However, it is only part of the picture. An equally important point was the recognition that financial globalisation enabled risk sharing between jurisdictions. Put another way, global flows of capital and financial services mean not only that one jurisdiction may be importing risks from elsewhere. It also means that a jurisdiction can diversify its risks among others. Although there were occasions when openness transmitted shocks, sometimes the transmission of shocks actually helped to diminish stress and avoid crises. These were in fact two faces of the same coin.

In turn, the assessment of whether it is better to restrict the import of risk from elsewhere or to maximise the ability to diversify one's own risk turns essentially on the confidence that one can have in others. The governance approach is intended to create the high standards and the machinery to provide that confidence. The current pandemic has generated very similar questions about the resilience of risk in the context of global supply chains, particularly – though not exclusively – in health-related areas. The empirical and theoretical evidence suggests that the global value chains are associated with better average economic performance. The evidence does not, however, suggest that that is necessarily associated with a greater degree of economic volatility. Risk diversification may be one of the reasons for this finding. As has been observed, "putting all your eggs in one basket does not diversify risk, even if the basket is at home".

As these familiar questions of local versus global are considered in the aftermath of the pandemic, I would single out three particular pointers on what in the financial sector has worked in the global governance approach. First, the importance of structures that are not political in themselves but have political legitimacy. These need to recognise both that their role is not to supplant domestic legislatures and that the common approach needs to have the flexibility to reflect domestic heterogeneity. The FSB, reporting to the G20 and working with technical standard setters has, by and large, achieved this balance.

The second pointer is the value of stress-testing which has become standard in financial regulation as a way of assessing and of providing confidence about the resilience of cross-border supply chains in sensitive areas in which jurisdictions want to ensure supply beyond consideration of economic gain or cost. International cooperation in identifying critical sectors and stress-testing them to key risks and transmission channels can build confidence, and it helps to resolve the buffer versus resilience a point that I mentioned earlier.

The third pointer is the importance of data and transparency in building resilience and in assessing risks. The financial reforms were underpinned by substantial efforts to improve data availability and sharing, to improve our understanding of the risks and the resilience in the global financial system. This has actually been one of the hardest elements of the post-crisis reform programme to implement fully, and there surely remain gaps - as the experience in March a year ago and this March illustrate. However, the experience of the past year has also shown that we are now in a much better position to assess and manage risks than we were 10 years ago. I suspect that better, more timely and more granular data on critical global supply chains might be a very important element of building a governance approach.

Finally, I want to look very briefly at the question from the other direction. The pandemic has inevitably focussed governments on the protection of their own citizens, on risks that can be transmitted across borders and on dependence on overseas supply. Will this have an impact on the approach taken towards the international flow of capital and financial services? There is no obvious, direct reason why it should do so. The dash for cash last spring, it is true, highlighted again the interconnectedness of financial markets across jurisdictions and it also highlighted some of the risks facing emerging markets in particular in the management of capital flows. But the response in the international community, as I have suggested earlier, has been an increased and cooperative effort to tackle some of the vulnerabilities that were revealed rather than any immediate push towards localisation.

The financial system does not, however, exist in a vacuum. Its governance domestically and internationally can be affected by prevailing political winds. A greater emphasis on strategic autonomy in the political discourse, a shift in the perceived balance of risks and rewards between localisation and international supply may in turn spill over and affect the commitment to the governance approach to the international financial system that I identified earlier. And in Europe, of course, the aftermath of Brexit may well add to such dynamics.

It is by no means certain that such a spill over will occur. The commitment following the financial crisis 10 years ago to the governance approach was not, as I have said, much affected in recent years by the weakening of international cooperation in other areas. But it does perhaps put a premium on showing that we can, using the structures that we put in place 10 years ago, tackle the vulnerabilities that we have identified in the financial system last spring. It perhaps also underlines the needs for the international regulatory community to continue to maintain cool heads and cool judgements. Thank you very much.