MARKUS RONNER

Group Chief Compliance and Governance Officer, UBS Group AG

More international coordination today to improve financial system resilience tomorrow

Following decades of global financial integration, we have begun to see some retrenchment, as evidenced by declining euro area portfolio investment flows since their peak in 2016. With global flows being reshaped as a result of geopolitical tensions, we have also seen continued financial fragmentation within Europe – not just as a result of Brexit but also due to continuing frictions between home and host countries.

The trend towards financial fragmentation has been aggravated further by COVID-19. While the banking industry appreciates the bold and swift policy reactions to the pandemic, the supervisory response to common issues brought about by the crisis appeared somewhat disjointed, with capital and liquidity relief measures diverging significantly across major jurisdictions.

An inward-looking focus may unfortunately undermine the encouraging progress in financial integration made since the 2008/09 financial crisis. Over time, this could negatively impact the pricing and availability of financial services within the EU.

The lack of consensus around the finalisation of the Too-Big-To-Fail (TBTF) reforms illustrates the scale of the challenge we now face. The industry has made great progress in terms of self-sufficiency (financial, processes and governance) within individual entities – around USD 300bn of TLAC built up globally in the first half of 2020 alone. Yet the global implementation of agreed reforms – highlighted by the FSB itself – remains uneven in important areas. These include cross-border coordination and allocation of internal TLAC, while open issues remain to be addressed consistently through closer regulatory cooperation, avoiding uncoordinated measures across host jurisdictions.

Open issues include 'funding in resolution' and ensuring a robust framework for the increasingly significant activity related to non-bank financial intermediation, where lessons need to be drawn from the market liquidity issues experienced in March 2020. A reliable, internationally consistent approach to central banks' Lender of Last Resort role will be crucial as a key enabler of an effective and credible bail-in tool. Together with other measures outlined below, this should encourage in particular host authorities to limit excessive pre-positioning requirements, as intended by the FSB in designing the TLAC framework. As a consequence, the increase in costs for banks, which would over time feed through to the economy, would be limited. Clearly this is important to support the recovery.

Moreover, there are several actions which could be taken to foster further international integration to the benefit of each individual country, given the global financial system remains highly interconnected, reflecting both supply and demand needs across jurisdictions. First, authorities need to follow through consistently on the reforms already started, such as completion of the Banking Union, the TBTF reforms and consistent implementation of Basel 3. It's also key to step up efforts to remove existing impediments to cross-border consolidation, which is the best route to attain financial integration.

Furthermore, regulatory cooperation will continue to be critical to address the global challenges posed by climate-related financial risks, cyber risk and operational resilience, the digitalisation of finance and financial crime / AML, to name just a few. Ideally this should be moderated by global fora such as the BCBS, the FSB and IOSCO and potentially broadened even further to a wide range of public authorities and stakeholders due to the cross-sectoral nature of many of these issues. We will otherwise risk ending up with a scattered landscape of rules across major jurisdictions for an additional range of highly critical topics which are, by their nature, global.

Taking sustainable finance as an example, global principles would fill a key gap, enabling regulation focused on disclosure, climate risk measurement and taxonomy to become clear, actionable and truly purposeful. The inflow rate for sustainable investing funds by the third quarter of 2020 amounted to 36% year-on-year in an otherwise fairly static fund market. If we want to unleash the full potential of private investors to direct the flow of capital towards facilitating the transition to net zero carbon emissions, internationally harmonised definitions and rules are essential.