Q&A

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Global market access challenge and Covid-19

Do you see increasing signs of market fragmentation at the global level due to Covid-19 events?

The uncertainty stemming from the pandemic and from the associated possible paths which our economies may take has brought new challenges to authorities across jurisdictions. The magnitude and shape of the impacts posed by market fragmentation on financial institutions, markets, and end users may now be both increasing and decreasing.

Obviously, the global economy has been subject to a significant economic shock caused by the rapid spread of Covid-19. In light of this, authorities rushed to reconstruct and implement policy measures in an expeditious manner under new operational settings and constraints.

There was no time to consult and coordinate, and these circumstances may have contributed to the risk of market fragmentation.

On the other hand, facing the same challenges, authorities across jurisdictions have taken similar measures even without prior coordination. Precautionary lockdown measures have tested the contingency plans of all financial market participants.

Financial institutions as well as authorities adopted work-from-home (WFH) arrangements at very short notice. Many jurisdictions introduced extraordinary support measures to alleviate the financial and economic impact of Covid-19.

These include a range of payment moratoria and government guarantees for bank loans. As time progresses, divergence among industries has been becoming apparent. At the same time, authorities have begun to consider how to phase out emergency measures.

Faced with these challenges, authorities have widely shared largely common policy objectives and priorities, which have formed an important factor for decreasing fragmentation.

What are the impacts of this increasing financial fragmentation? How have authorities responded?

How the authorities work closely and coordinate action to maintain global financial stability is the right place to start. Before touching upon specific measures, I should mention that effective international regulatory and supervisory cooperation is an important precondition for integrated financial markets and cross-border financial activity.

From the beginning of the pandemic, the FSB, working with the standard-setting bodies, has facilitated a timely and effective information sharing mechanism with regard to the policy measures that the authorities are taking or are considering.

Authorities also took concerted communication strategies. For example, the Basel Committee on Banking Supervision published a series of statements and papers since March 2020 in order to announce authorities' objectives and priorities, provide the technical interpretations of the standards, and stress the flexibility embedded in the standards.

More generally, in April 2020, the FSB set five principles for official sectors, namely: to monitor and share information on a timely basis to assess and address financial stability risks from Covid-19; to recognize and use the flexibility built into existing financial standards to support the response; to seek opportunities to temporarily reduce operational burdens on firms and authorities; to act consistently with international standards rather than rolling back reforms or compromising the underlying objectives of existing international standards; and to coordinate on the future timely unwinding of the temporary measures taken. These principles underpinned the official community's rapid and coordinated response to support the real economy, maintain financial stability and minimize the risk of market fragmentation.

Authorities faced the pandemic almost simultaneously; however the timing and route to start moving toward exits may differ depending on the risk of premature lifting of multiple measures and the cliff arising from the cumulative effects of unwinding them. That is why monitoring is so important.

While the current events demonstrate once again the importance of a resilient financial system, G20 financial regulatory reforms will contribute to further reinforcement. Also, full, timely and consistent adoption and implementation of Basel III will benefit financial stability.

In addition to this, what kind of challenges are there and how can we address and mitigate these challenges from the perspectives of market fragmentation?

In the "conventional" sense, we have discussed market fragmentation with the assumption that the financial activities are still bounded by the jurisdictional borders with the physical presence of entities providing services. Thus, different regulatory and supervisory approaches to such entities in different jurisdictions cause fragmentation among international markets. However, such an assumption may not be the case for rapidly developing more borderless financial activity without, in some cases, a physical presence.

The case of global stablecoins is typical of such new developments, as entities within a global stablecoin arrangement may spread in multiple jurisdictions. In addition, a large, globally operating platform easily allows users to perform financial transactions across the globe. As a result, financial authorities are required to address associated risks through global regulatory and supervisory actions even before implementation.

More recently, so-called decentralized finance, which is provided by a combination of computer codes of smart contracts, enables completely borderless financial activities in cyberspace. Coordinated and comprehensive regulatory approaches are essential for the effective supervision and sound development of these activities.

Technology is there to migrate more financial activities to cyberspace for more frictionless financial transactions; however, jurisdictional borders between their own regulatory and supervisory approaches still prevent users from enjoying the full benefits. For example, we are still frustrated by expensive, slow and less-transparent cross-border payment and remittance, which the FSB and other international organizations are tackling with guidance from the G20.

In addition, the more financial activities migrate to cyberspace, the more important global response to cyber risks will become. In a broader sense, jurisdictionally fragmented response to operational incidents would not be enough to achieve a sufficient level of operational resilience of financial service providers.

In short, we are facing new challenges, as the nature of financial services changes from jurisdictionally bounded financial institutions with a physical presence to borderless financial activities in cyberspace without a physical presence.

What do we need to do going forward with regard to market fragmentation?

The last eighteen months of the fight against the Covid-19 pandemic reminds us that even the closing of physical borders can neither stop financial activities across borders nor break the financial system into pieces. The financial system is still global and becoming even more borderless, as we are all aware. Thus, avoiding harmful fragmentation is becoming even more important.

The good news we have learned through these difficult last eighteen months, is that financial authorities have been capable of maintaining close cooperation and coordination even without travel and physical meetings thanks to technological developments, such as rapidly developing video conference systems. As we are entering a new normal and may be becoming a world with a more borderless financial system, at financial authorities, we need to prepare ourselves for this new reality in a forward-looking manner. And I believe we can.