Klaas Knot: Strengthening financial resilience - lessons from Pittsburgh

Speech by Mr Klaas Knot, Chair of the Financial Stability Board and President of the Netherlands Bank, at the Bloomberg Global Regulatory Forum, New York City, 22 October 2024.

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Good morning everyone.

It could have been right here in New York City.

That would have been fitting, as this city was, and still is, the center of gravity for global finance. But, as it happened, the US administration made a last-minute decision to pick Pittsburgh as the venue for the G20 summit.

We are back in the fall of 2009. Less than a year earlier, when G20 leaders first met in Washington DC, the world economy had been facing its greatest crisis in generations. At the Pittsburgh Summit, the memory of the crisis was still fresh. The fall of Lehman. The rescue of AIG. The race against the clock to prevent a total meltdown of the financial system. Leaders from the 20 largest nations in the world had all gone through those fateful crisis days. They shared a conviction that this should not happen again. Ever. They decided on a massive strengthening of regulation to address the weaknesses in the global financial system and to curb excessive risk taking. And they endorsed the mandate of the newly established Financial Stability Board to coordinate and monitor progress. Pittsburgh turned the tide.

The rest is history. But it is an unfinished history. For sure, the reforms that were agreed in Pittsburgh did substantially strengthen the global financial system.

In recent years, markets have experienced several episodes of turmoil, and we have seen potentially destabilising failures of banks and non-banks. But the core of the system has held up relatively well. So, one interpretation is that the financial system has proved to be resilient. But that is not entirely true. Take March 2020 for example. This turmoil was contained both through improved resilience and unprecedented policy actions. Without the combined force of these policy actions, the reforms implemented since 2009 may have not been sufficient to stave off another financial crisis. And it's not only in 2020 that unprecedented policy actions were needed. In 2023 the fire brigade had to turn out again.

So, we've made progress, but there is much left to do if we want a truly resilient financial system. One that can finance the economy through thick and thin without recourse to extraordinary support. Furthermore, the financial system is evolving, and so must our regulations. Can we keep up the pace? Allow me to share some concerns about that.

First of all, our work to make the banking sector more resilient is not yet complete. For one thing, the final Basel III standards still need to be implemented in many jurisdictions. In the meantime, the banking turmoil in March last year was a reminder that bank runs are not a thing of the past. The demise of Silicon Valley Bank and Credit Suisse not only brought lessons for banks and supervisors.

They also highlighted that 13 years after the FSB issued its Key Attributes for Effective Resolution Regimes, authorities still face challenges in dealing with failing banks.

Next to the unfinished agenda in banking, the non-bank financial sector continues to face serious vulnerabilities. Partly as a response to strengthening banking regulation, non-bank financial institutions are playing a larger role in financing the real economy, now accounting for nearly half of total global financial assets. And as we have seen over the past few years, structural vulnerabilities in the sector have the potential to cause systemic risk. These include liquidity mismatches, leverage, and inadequate margin preparedness. The FSB, working with other standard setters, has done a great deal of work on this issue. We have issued policy recommendations in several key areas. Drawing up these policy recommendations, however, is not enough to stem systemic risk in NBFI. For that to happen, we must implement them. That means authorities must not only put them into national laws and regulations, they must also have the capacity to operationalize them.

Third, technological innovation continues to shape the way the financial sector functions, and it adds another layer of complexity. Technology can create new interdependencies, for example when many financial institutions rely on the same service providers. It can also increase the speed at which a crisis unfolds. And technology raises important questions about the regulatory perimeter. Above all technology related risks can exacerbate pre-existing vulnerabilities in the financial system and may create new ones. Take crypto-assets. This fast-growing market has seen more than its fair share of bankruptcies, liquidity crises and outright fraud, even as its links with traditional finance continue to grow. The FSB has issued recommendations to regulate the market for crypto-assets. The G20 has endorsed these recommendations and, again, they now need to be implemented globally.

As you might notice, I'm talking a lot about implementation, because that's where my concern lies. It seems that, 16 years after Lehman, implementation fatigue has started to set in. Political commitment for maintaining financial stability is usually the highest when the collective memory of the last crisis is still fresh. When this memory starts to fade, there is the risk that financial stability is taken for granted. Something that can be left to the bureaucrats, to the technicians. Not least because there are so many other policy priorities to deal with for governments. But that would be a mistake. We do need the involvement of politicians, of lawmakers, because without them, it becomes even harder to implement necessary regulations. After all, financial stability is the foundation for almost all public policy. If financial stability is gone, as a government you can forget about the other policy priorities. You will spend most of your time drawing up rescue plans for an economy in free fall. So we should not wait for the next crisis.

We also need commitment in good times, when the work to develop and implement policy needs to get done. This commitment is even more important in a world that is getting more fragmented, both politically and economically. I am concerned about our capacity to work together on cross-border challenges in such a world. During the Global Financial Crisis, policymakers around the globe were able to respond swiftly and effectively. In a fragmented world, such a swift response could become more complicated. This could prove costly because the most important challenges to financial stability are precisely the cross-border issues that we can only solve if we work together.

And to the financial industry I would say: rules that strengthen the resilience of the financial system are in your best interest too. Some in the industry view regulation as a constraint, something that limits profitability and imposes undue costs. But it's just the other way around. Financial regulation is not an obstacle, it is an enabler of sustainable, long-term growth. Globally implemented regulation strengthens international financial stability, levels the playing field, and, in turn, enhances the confidence of your shareholders, clients, and counterparties. Strong regulation is not a constraint on the financial industry, it is an asset.

15 years after Pittsburgh, strengthening the financial system is an unfinished history. Partly that comes with the job. The financial system is always evolving, so our policy also needs to evolve. But, that's not the only reason. It is also important that authorities finish implementing the measures we've all agreed are needed to address existing vulnerabilities. Vulnerabilities that could lead to the next crisis, if they are allowed to persist.

This calls for maintaining our ambition as policy makers, and for law makers to take the agreed policies all the way through to implementation. I wish for us to have the determination and collaborative spirit that the leaders in Pittsburgh collectively felt. Let's work together to finish what we started. Let's stay sharp, focused and committed to preserving financial stability. And where better to express that commitment than in the city that never sleeps.