NLI Research Institute REPORT

Reflections on Financial Regulators' Initial Responses to COVID-19

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More than two years have passed since the outbreak of COVID-19. The world may have to live with the pandemic and its legacies for further years, but the two years may already allow us to look back on the initial emergency responses and attempt to tentatively assess them.

At the time of the outbreak and until September 2021, the author chaired the Standing Committee on Supervisory and Regulatory Cooperation (SRC) of the Financial Stability Board (FSB), which globally coordinated financial sector policy responses to the pandemic. Below are my recollections of financial regulators' concerns, how they designed the responses, and the role that financial sector policy played as part of the overall economic policy responses. I focus on global responses but also refer to Japanese initiatives.

The first section describes the four main concerns regulators had at the onset. The second section reviews the responses to address concerns over operational risks. The third section discusses responses to market and liquidity risks. The fourth section is about responses to secure continued financing while addressing solvency risks, and the fifth section reviews the modality of international coordination. The sixth section concludes.

Each jurisdiction faced different challenges. The unprecedented shock resulted in diversity in views even within a jurisdiction. I highlight a common denominator but will inevitably be biased by my personal views. The narrative will not necessarily represent the view of the FSB or its member institutions or the Japanese Financial Services Agency (JFSA) at the time.

1――Four concerns

The pandemic shocked the real economy, affecting both the demand and supply sides. The demand for products needed for remote work soared but demand for face-to-face services such as

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restaurants, hotels, and transportation plummeted. Global supply chains were disrupted, clogging the supply of many products. Overall, the demand shock in 2020 significantly surpassed the supply shock and exerted deflationary pressure on the economy. For example, in the first half of 2020, much larger numbers of Japanese corporations than before the pandemic found that supply exceeded demand (Figure 1).

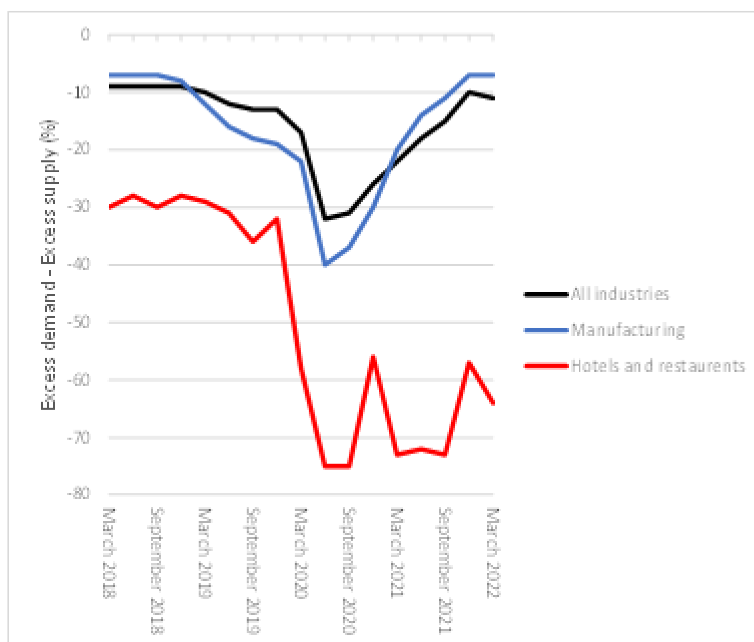

Figure 1: View of Japanese corporations on domestic demand and supply

Source: Bank of Japan, Short-Term Economic Survey of Enterprises, March 2022. All company sizes, views on current conditions.

The financial system should support the corporate and household sectors to weather a temporary external shock, but the system has sometimes accelerated downward spirals in the past. The regulators aimed to ensure that the financial system would work as a shock absorber rather than as an amplifier.

The financial sector policy makers had to address the following four concerns to attain this aim.

(1). Operational risks

Regulators were concerned that the infection and public health policy measures such as lockdowns may disrupt the business continuity of financial institutions. They were also concerned that dependencies on remote work may increase the vulnerability against cyber and IT incidents.

(2). Credit crunch

Bankers are said to lend umbrellas on sunny days and take them back on rainy days. If bankers

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become excessively risk-averse, healthy corporations and households that face temporary cash shortages but have good prospects of recovering after the pandemic could unnecessarily go bankrupt. Households could be forced to sell their residences or face an impaired credit record and lose future recovery opportunities.

Regulators were also concerned whether the financial system could bear the shock.

(3). Market and liquidity risks

Financial institutions might incur losses due to increased market volatility arising from uncertain economic prospects. Market participants may become cautious about the counterparties' credit standing and their own funding, refraining from purchasing assets and consequently lowering market liquidity. Declines in market liquidity aggravate the funding liquidity of entities as they cannot obtain cash by selling assets. Funding fears could lead to a run on the capital market.

(4). Solvency risks

If the COVID-19 pandemic continues to deprive corporations and households of revenues, banks' loans to them may soar and the solvency of banks might be impaired. Problems at banks can exacerbate the credit crunch, market volatility, and liquidity shortages. A vicious circle between financial and economic crises could then be triggered.

Initially, COVID-19 was considered an issue unique to China, but the second week of March 2020 saw a sudden change in perceptions. New York State declared an emergency on Saturday, March 7, 2020. Italy started a lockdown on Monday, March 9, and the World Health Organization declared a pandemic on Wednesday, March 11. U.S. President Donald Trump declared an emergency on Friday, March 13.

Regulatory authorities globally started to explore responses in financial sector policies while facing uncertainties over

- How long the pandemic would persist
- Whether a second or third wave would come
- When vaccines and remedies would become available
- How effective vaccines would be
- How the pandemic would affect supply and demand
- What the post-COVID-19 economy and society would be like.

Despite the uncertainties, regulators acted promptly. Figure 2 shows the changes in the cumulative numbers of policy measures taken. According to the FSB, "The speed, scale and scope

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of the policy response to COVID-19 was without precedent." [1] Indeed, within a month from the second week of March 2020, more than 1,000 new measures were taken ranging from those supporting operational resilience (red) to lending support (yellow), funding support (blue), monetary and fiscal policy measures (purple), and those related to market functioning (brown).

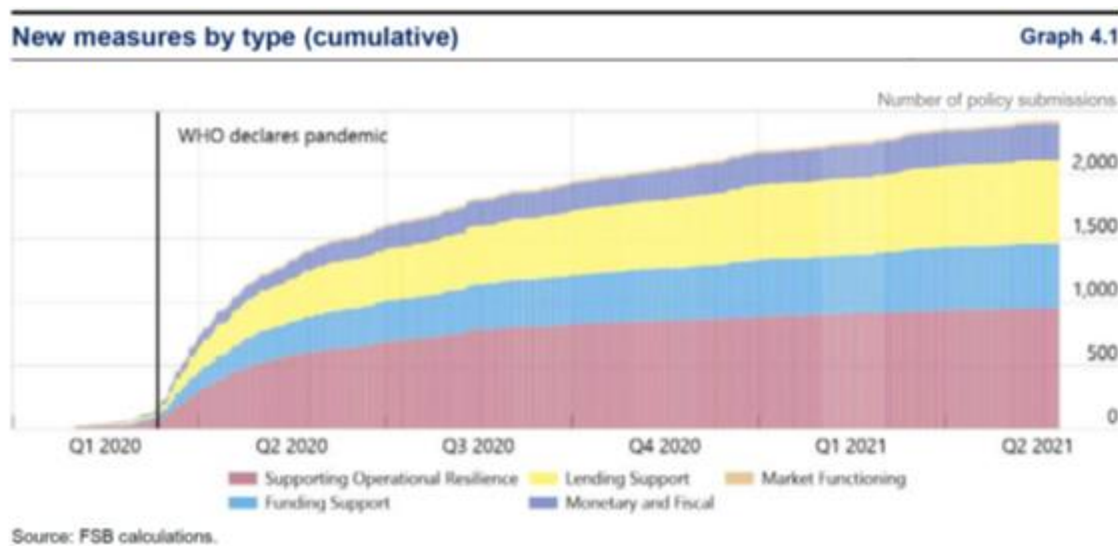

Figure 2: Cumulative numbers of policy measures taken

Source: Financial Stability Board, Lessons Learnt From the COVID-19 Pandemic From a Financial Stability Perspective: Interim Report, July 2021

2——Responses to address operational risk concerns

The COVID-19 pandemic constrained the business continuity of financial institutions via lockdown and other channels. The FSB published a message to public health authorities to ensure continuity of critical financial service functions.[2] National authorities also acted. For example, in response to the declaration of emergency in Japan, the JFSA published guidance for various sectors of financial services on how the prevention of infection and continuity of core functions should be balanced.

National authorities took the following types of measures to reduce regulatory and supervisory burdens on financial institutions so that they could concentrate the available resources on activities indispensable for customers:

– Postponing the scheduled implementation of new international standards. For example, the JFSA announced on May 30, 2020, to extend the domestic implementation of the finalized Basel III standards by one year, in line with the agreement of the Basel Committee on Banking

[1] Financial Stability Board, Lessons Learnt From the COVID-19 Pandemic From a Financial Stability Perspective: Interim Report, July 2021.
[2] Financial Stability Board, FSB members take action to ensure continuity of critical financial services functions, April 2, 2020.

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Supervision.[3]

– Extending deadlines for reporting to the authorities and for public disclosure. For example, the JFSA announced on the same day that it would flexibly treat the deadlines.

– Postponing on-site inspection. For example, the JFSA started to postpone on-site inspections in the latter half of February 2020.

– Replacing face-to-face processes with virtual interactions. For example, the JFSA started to attempt remote inspections in the second half of February 2020.

Regulators also requested the following from financial institutions to ensure business continuity:

– Producing business continuity plans to prepare for a further spread of infections. In Japan, plans that had been in place to prepare for earthquakes and novel influenza were found to be useful.

– Preparing for cyberattacks and IT systems disruptions. The JFSA hosted an industry-wide war game in a remote working environment in October 2020.

Though lockdowns and other public health measures lasted much longer than initially expected, financial institutions and market infrastructure succeeded in effectively addressing operational risk concerns. Despite surging business activities including the provision of bridge loans and underwriting of bonds, business continuity was largely maintained. Ransomware incidents are on the increase, but cyberattacks have thus far not caused a major disruption of financial functions.

Dedicated efforts by financial institutions made these outcomes possible. The lessons of 9/11 resulted in better preparedness for remote working in the United States. In Japan, the pandemic advanced digitalization and remote working.

3――Responses to address market and liquidity risks

While the operational risk concerns have been reasonably well addressed, market and liquidity risks brought the global financial system to the brink of breakdown. The U.S. Federal Reserve Board (Fed) and other central banks, however, contained the crisis by the rapid mobilization of all

[3] Basel Committee on Banking Supervision, Governors and Heads of Supervision announce deferral of Basel III implementation to increase operational capacity of banks and supervisors to respond to COVID-19, March 27, 2020.

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available tools and an enormous supply of liquidity.[4]

The market became volatile in late February 2020 and started to panic in mid-March when the lockdown was implemented in Europe and the United States. Market participants dashed for cash, exchanging U.S. treasuries, gold, and Japanese yen, which had been thought to be safe assets, into cash dollars. This run on the market resulted in the termination of new issues of corporate bonds, near depletion of cash for redemption of investment funds, and the choking of funding in U.S. dollars outside the United States.

The U.S. Federal Reserve commenced a blitzkrieg in response to this development, launching new measures daily from Sunday, March 15, and exhausting the playbook developed during the global financial crisis (GFC), as Exhibit 3 shows.

Date	Type	Specific response
Sun, March 15	Liquidity support	Augmenting dollar swap arrangements with five central banks
	Monetary policy	Zero interest rate policy and quantitative easing (implemented on 3/16)
Tue, March 17	Asset purchase	Commercial Paper Funding Facility
	Liquidity support	Primary Dealer Credit Facility
	Regulatory relief	Temporary exemption of program assets from capital requirements
Wed, March 18	Liquidity support	Money Market Mutual Fund Liquidity Facility
Thu, March 19	Liquidity support	Central bank U.S. dollar swap lines with nine jurisdictions
	Regulatory relief	Money market fund sponsors able to buy assets from affiliates
Mon, March 23	Asset purchase	Primary and Secondary Market Corporate Credit Facilities
	Asset purchase	Purchases of treasury securities in “amounts needed”
Tue, March 31	Liquidity supply	Facility for Foreign and International Monetary Authorities
Thu, April 1	Regulatory relief	Temporary exemption of government bonds and central bank deposits from supplementary leverage ratio

Figure 3: Emergency measures taken by the U.S. Federal Reserve in response to the March 2020 market turmoil

Source: Compiled by the author based on FSB, Holistic Review of the March Market Turmoil, November 2020

The balance sheet of the Federal Reserve expanded by $1.5 trillion during the three weeks between March 11 and April 1, 2020. The corresponding amount of funds should have been injected to the market. The panic peaked on around March 20 and then subsided, but the Fed balance sheet

[4] For more detailed descriptions, see Financial Stability Board, Holistic Review of the March Market Turmoil, November 2020.

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grew by further $1.3 trillion by the end of May. Comparison of this with the increase in the wake of the collapse of Lehman Brothers, which was $1.2 trillion, may illustrate the thoroughness of the response.

Other central banks' activities were also agile and powerful. For example, the Bank of Japan announced on Monday, March 16, that it enhanced supply of dollar liquidity utilizing an augmented swap arrangement with the U.S. Federal Reserve. This initiative helped the dollar funding of Japanese banks, providing close to $200 billion.

Despite many ensuing waves of infection, the world's financial system stayed stable and continue to support the real economy. The overwhelming firepower employed by the U.S. Federal Reserve must have underpinned this. If the Fed had been too little, too late in March 2020, the world would have looked utterly different from what we see today.

The debate on the lessons from the March 2020 market turmoil continues. During the incident, banks largely functioned without major problems, and the debate focused on issues surrounding investment funds including money market funds and capital markets including U.S. treasuries and the commercial paper markets.

On the one hand, many central bankers argue that the exceptional responses in March should not be repeated and that globally uniform regulations should be imposed on the nonbank financial sector, which now holds half of the world's financial assets, lest similar funding problems should recur.

On the other hand, many capital market regulators maintain that it is the role of central banks to mitigate extreme tail events and that if you demand that market participants to be prepared for any exceptional development, the market in peacetime would be stifled.

The debate continues, but remedial measures are being developed. The FSB published a comprehensive work program[5] and specific proposals. Even the most specific proposal, or that on Money Market Fund (MMF),[6] however, entails significant range of national discretion, and we need to see the outcome of the peer review planned in 2023 to ascertain the effectiveness of the reform. Studies on the way to enhance the resilience of other nonbank sectors have also begun, but it would take several more years before remedies are agreed and implemented.

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[5] "Table 1: Planned deliverables under the FSB's NBFI Work Programme" of Financial Stability Board, Enhancing the Resilience of Non-Bank Financial Intermediation: Progress report, November 2021.

[6] Financial Stability Board, Policy proposals to enhance money market fund resilience: Final report, October 2021

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The vulnerabilities of the nonbank financial sector were among the key factors exacerbating the GFC. The views did not converge enough between central bankers and capital market regulators in the wake of that crisis either, and the agreed remedial measures were perhaps not effective enough. It may be said that the incomplete homework from the GFC led to the March 2020 turmoil.

Following the GFC, authorities tightened banking regulations and eased monetary policy. Though the tightened banking regulation contributed to the banks' resilience against the COVID-19 shock, it could also be said that the combination of tight banking regulation and easy monetary policy helped nonbank financial sector's inordinate growth and thus exacerbated the March dash for cash.

In July 2021, the U.S. Federal Reserve reintroduced the repo facilities for domestic market participants and for foreign and international monetary authorities adopted in March 2020. This may have been intended as a cautionary measure to prevent market turbulences while unwinding the extraordinary liquidity provision since March 2020.

In November 2021, the Fed began to taper the monthly asset purchase amount. A decline in market liquidity was observed since then for Treasury bonds and stock and oil futures.[7] Quantitative tightening started in June 2022.

The processes to address the legacies of the March 2020 market turbulence are far from complete despite more than two years passing since the incident.

4――Responses to prevent a credit crunch and to address solvency risks

After the March 2020 liquidity risk incident, many regulators recalled past crises where liquidity risk phases were followed by solvency risk phases. The infection and lockdown put a brake on supply and demand, and the corporate and household sectors lost revenues. If the pandemic continues, banks' loans to them may stop performing, causing credit losses on banks.

On the other hand, if banks, being wary of creating bad loans, take back the umbrella on rainy days and cause credit crunch, firms which can resurrect after the pandemic will unnecessarily go bankrupt. Households, which can start to repay the mortgage after the pandemic, may have to sell their houses.

[7] See Box 1.1. Recent Liquidity Strains across U.S. Treasury, Equity Index Futures, and Oil Futures Markets, of Board of Governors of Federal Reserve System, Financial Stability Report, May 2022

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There are both interdependency and trade-offs between the financial stability and the continued availability of financing.

The financial stability and the availability of financing are interdependent. If the credit crunch exacerbates the recession, the recession increases bad loans and destabilize the financial system, and impaired financial stability worsen the credit crunch. Unless we both have financial stability and financing, we cannot have even one of the two.

There are, however, tradeoffs between the financial stability and financing as well. If another wave of the pandemic further deepens the recession after banks abundantly provide bridge financing, big bad loans may be created and impair financial stability. If banks prioritize not running the risk of creating bad loans, firms and households cannot get bridge financing.

In addition to this coexistence of interdependency and tradeoffs, the following factors further complicated the matter.

First, the fallacy of composition. A policy rational to an individual bank may not be rational for the financial system as a whole or for the economy overall.

A bank that unduly turns its back on customers in need will not be trusted and will lose businesses in the longer term, and banks with enough financial clout will continue to support viable customers.

But those banks without enough capital will have to prioritize minimizing immediate credit losses. As actions by an individual bank alone cannot sustain the whole economy, it may refrain from lending to customers without existing relationship or with higher risks. If each bank makes such choices, the recession will become deep, and all banks may have to bear large credit losses.

Second, uncertainty about the COVID-19. The amount of losses a firm or a household will accumulate depends on the duration of the pandemic, its impact on the economy, and the government support to the firms, households, and economy. The banks had to make lending decision without knowing these factors.

Third, uncertainty about the post-COVID-19 era. After the pandemic, will people continue to use Zoom for meetings or resume business trips? Will tourist from abroad start sightseeing? Will there be big parties and wedding ceremonies? Will the borrower firm be capable to seize new business opportunities? A bank cannot determine if the bridge financing will lead to the other shore without

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knowing the answers to these questions, which nobody knows.

Facing these complications, financial regulators took policy measures to ensure both the financial stability and the availability of financing.

The JFSA had maintained since several years before the pandemic that its mission was to realize both financial stability and effective financial intermediation.[8] This had been an outlier view as many regulators around the world considered their unique mission was securing financial stability. Since the outbreak of the pandemic, however, most regulators worked to secure effective financial intermediation as well.

Specifically, regulators adopted the following measures:

– Release of the countercyclical buffer

  Basel III, the international standards on bank capital adequacy, incorporates the framework of the counter-cyclical buffer, in which regulators discretionally set add-on to capital requirement in view of the changing business conditions. European and other authorities, who had set add-ons before the pandemic, released them. Japanese and U.S. authorities had not established add-ons and therefore had no room for releasing buffers.

– Encouragement to use other buffers

  Basel III framework incorporates standing buffers in addition to the releasable counter-cyclical one. The Basel Committee on Banking Supervision and national authorities including the JFSA confirmed that the buffers exist to be used in times of need such as the current pandemic and attempted to alleviate banks' concerns about dipping into buffers.

– Clarification on loan loss reserves

  As part of the post-GFC reforms, the International Financial Reporting Standards (IFRS) and U.S. accounting standards have come to request that loan loss provisions be set in a forward-looking manner. Accounting standard setters clarified that the requirement should not be implemented mechanically given the difficulty in foreseeing the impacts of COVID-19.

  The Accounting Standard Board of Japan (ASBJ) announced that deviation between the ex-ante best estimation and the ex-post outcome should not constitute an error unless the assumptions adopted by the reporting entities are clearly unreasonable. The JFSA announced

[8] See, for example, Ryozo Himino, Replacing checklists with engagement, March 2018

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that it would respect judgements by banks when conducting on-site inspections.

– Encouragement to accommodate funding needs

Authorities encouraged banks to accommodate funding needs. In Japan, the Minister for Financial Services released statements thirteen times on the occasion of the declarations of emergency and other occasions. The JFSA continuously surveyed borrowers' views and requested banks to address identified problems. The requests were issued 34 times.

– Moratorium

Many jurisdictions took various forms of measures to allow repayment deferrals. Germany and other jurisdictions temporarily terminated filing of bankruptcy. On March 6, 2020, the JFSA requested financial institutions to respond to borrowers' request to change lending terms including payment deferrals in a prompt and flexible manner and announced that it would publish the percentage of the requests accommodated. Almost all requests have been accommodated.

To secure financial stability, regulators took the following measures:

– Restraining dividends and share buybacks

European authorities requested banks to stop dividend payouts and share buybacks. U.S. authorities set limits on capital disbursements according to the outcome of stress tests. The JFSA had a dialogue with individual banks according to their specific conditions.

– Stress tests

UK authorities published the outcome of stress tests confirming that increased lending or pandemic-induced bad loans would not endanger financial stability. The outcome justified the regulator's encouragement to continue lending.

– Public support to banks

Japan amended the Act on Special Measures for Strengthening Financial Functions in June 2020 to allow public fund injections to financial institutions needing to enhance their capital adequacy to continue to support the economy.

Other authorities, which used to deny the use of public funds, started to show nuanced changes. For example, a report by the FSB in March 2021 stated:

> [S]ignificant progress has been made since the global financial crisis in establishing and

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operationalizing frameworks for the resolution of systemically important banks. These reforms give authorities more options for dealing with banks in distress, though which options are used is for authorities to consider in their particular circumstances.[9]

The sentences could be interpreted to implicitly accept that the bail-in options introduced post-GFC are not necessarily the only available options.

The regulatory responses described above should have contributed to financial stability and the prevention of a credit crunch. Their effectiveness, however, had certain limitations. For example, banks globally continued to hesitate to use buffers despite encouragement from regulators. U.S. banks posted enormous loan loss reserves despite the clarifications offered by accounting standard bodies and regulators.

The financial system maintained its stability and continued to support the economy perhaps due to the combined effects of (1) the regulatory responses listed above, (2) fiscal policy, (3) monetary policy, and (4) post-GFC regulatory reforms. Most likely, all the four were indispensable.

The fiscal policy pursued provided grants and subsidies to households and corporations, compensating for the loss of revenue and alleviating the deterioration of balance sheets. Public guarantees made it possible for banks to lend without fearing future credit losses. Exhibit 4 shows the variety and expanse of the measures taken to support corporate borrowers in Japan.

[9] Financial Stability Board, Evaluation of the Effects of Too-Big-To-Fail Reforms: Final Report, April 2021

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	Major measures to support corporate financing	Overview of measures	Fiscal expenses and total size of measures
Cash payments	Subsidies for sustaining businesses	Cash payments for SMEs and sole proprietors (up to 2 mil. yen)	5.7 tril. yen
	Rent assistance subsidies	Cash payments for supporting rent payments (up to 6 mil. yen)	1.1 tril. yen
	Expansion of employment adjustment subsidies program, etc.	Subsidy rates increased for leave allowance (up to 100%)	4.6 tril. yen
	Cooperation fees for shortening business hours	Cash payments for restaurants, etc. that cooperate with local governments' requests, such as shortening their business hours during the state of emergency (grants are delivered to each prefecture)	3.6 tril. yen
	One-off support payments and monthly support payments	Cash payments for SMEs and sole proprietors during the state of emergency, etc. (up to 0.2 mil. yen per month)	0.7 tril. yen
Tax measures	Special tax measures such as tax payment moratorium	National and local taxes and/or social insurance contributions possibly deferred for one year	Approx. 26 tril. yen
Financial measures	Effectively interest-free loans by government-affiliated and private financial institutions	Interest subsidies provided to government-affiliated and private financial institutions	Approx. 110 tril. yen
	Crisis response loans to medium-sized and large firms by government-affiliated financial institutions	Long-term loans with preferential interest rates through government-affiliated financial institutions	Approx. 10 tril. yen
	Equity support by government-affiliated financial institutions and funds	Equity support, mainly through subordinated loans and capital injections	Approx. 12 tril. yen

Note: Based on announcements by the government until end-August 2021. "Fiscal expenses" includes the expenses from contingency funds and announced budget diversions.
Source: Cabinet Office; Ministry of Finance; Ministry of Health, Labour and Welfare.

Exhibit 4: Overview of measures to support corporate financing in Japan
Source: Bank of Japan, Financial Stability Report, October 2021

Monetary policy in countries with room to reduce policy rates moved to alleviate the interest-payment burden on corporations and households. Central banks adopted programs to purchase large amounts of assets with credit risk and long maturities and to support banks' lending to borrowers in need.

In addition, post-GFC regulatory reforms ensured banks' strong balance sheets, which enabled banks to support the economy while maintaining soundness.

A devastating solvency risk phase did not materialize, which regulators had initially feared seeing following the March 2020 liquidity risk phase. In addition to the four factors above, quick recovery in the manufacturing sector contributed to this outcome.

As Exhibit 1 demonstrates, we observed a K-shaped recovery, where all industries initially recorded a crash, and then some industries recovered while others stagnated. This is of course much worse than a V-shaped recovery, but better than an L-shaped recovery.

The corporate sector in Japan entered the pandemic era with a solid balance sheet, after

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retaining earnings and hoarding cash for decades, but pre-pandemic U.S. corporations were seen to have accumulated excessive debts. Some feared that the vulnerabilities might be exposed by the COVID-19 shock. Indeed, the default rate of U.S. high-yield bonds increased from pre-pandemic level of less than 3% to around 7% in the middle of 2020. Though rating agencies anticipated a further rise, however, the default rate then stabilized and returned to the pre-pandemic level by mid-2021. The default rate of European non-investment grade bonds showed a similar trajectory.

In November 2021, the U.S. Federal Reserve stated that the vulnerabilities arising from business debt returned to the pre-pandemic level.[10] Continued recovery of earnings, the low level of interest rates, support from the Paycheck Protection Program (PPP), and fiscal stimulus contributed. Household vulnerabilities also returned to the pre-pandemic level. A combination of extensions in borrower relief programs, fiscal stimulus, and high personal savings rates have helped the recovery of household balance sheets.

In the same month, the European Central Bank also stated that corporate debt-servicing capacity improved due to low financing costs, increased revenues, and continued public support measures, and that near-term euro area corporate insolvency concerns fell.[11]

For a definitive conclusion, it is necessary to see what impacts could arise from lifting the support measures and rising policy rates going forward. It is already evident, however, that the combination of regulatory, fiscal, and monetary responses has been highly effective in addressing the concern about financial stability and securing continued financial support for the economy.

5——International coordination

I served as the chair of the FSB's Standing Committee on Supervisory and Regulatory Cooperation (SRC) from August 2019 to September 2021.

Within the FSB, the Standing Committee on Assessment of Vulnerabilities (SCAV) analyzed the impact COVID-19 had on the financial system and market. Based on the SCAV's analysis, the SRC proposed policy responses, and the Standing Committee on Standards Implementation (SCSI) monitored the implementation of the agreed responses. The SRC had 24 virtual meetings and published 23 reports and recommendations during the 19 months between the outbreak of the pandemic and September 2021, when I handed over the chair to Governor Bailey of the Bank of England.[12]

[10] Board of Governors of the Federal Reserve System, Financial Stability Report, November 2021
[11] European Central Bank, Financial Stability Review, November 2021
[12] The member of the FSB secretariat in charge of SRC was Yasushi Shiina, who before joining the secretariat was a staff member of the JFSA. He repeated several times a month a cycle of setting agenda, coordinating the drafting of meeting documents, coordination with

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The SRC convened an online workshop in May 2020 to discuss what could occur and what should be done, inviting financial institutions, exchanges, and credit rating companies. The following introductory remarks I made at the workshop may convey how the regulators were feeling their way at the very early stage of the pandemic.[13]

> Thank you everyone for joining this conversation.
>
> Facing the COVID-19 pandemic, the financial sector needs to meet three challenges: supporting the economy, sustaining itself, and preparing for the recovery. The official sector has strived to assist the private sector's efforts to meet these challenges.
>
> National authorities have taken agile actions: there are already 1,600 policy actions registered in the FSB database. Standard-setting bodies issued a series of guidance to extend the implementation timelines and to encourage the use of flexibility.
>
> Individual jurisdictions tailored their responses to their own conditions but have coordinated with each other with the following five principles in mind:
> First, we monitor and share information to address risks;
> Second, we use the flexibility built into existing financial standards;
> Third, we seek opportunities to temporarily reduce operational burdens on firms and authorities;
> Fourth, we act consistently with international standards, and will not roll back reforms; and
> Fifth, we will coordinate on the future timely unwinding of the temporary measures taken.
>
> And these principles were endorsed by the G20 Finance Ministers and Central Bank Governors in April.
>
> The global financial system has entered the crisis with much enhanced resilience, as a result of your efforts and the G20 regulatory reforms. We have to admit that the shock in March was beyond the self-healing ability of the market: massive central bank actions were required to end the heightened volatility. But the banking sector has continued to finance the real economy and, in late March, capital markets started to resume their normal functions. Financial market infrastructures, including CCPs, have functioned well, despite the challenging external conditions, both financial and operational.
>
> But we cannot be complacent. The world still faces an unprecedented level of uncertainty. We need to be prepared for a wide range of scenarios. What I would like to discuss today is how we should act at different phases of the crisis under a range of scenarios.
>
> Looking back, what lessons can we draw from the policy measures already taken? What measures seem to be working well and what are not? Have we observed operational frictions or obstacles, trade-offs and potential unintended effects? How can we enhance the effectiveness of the measures taken?
>
> And looking forward, what kind of possible developments should we be attentive to? Which

member authorities, briefing to the chair, drafting of the meeting summary, reporting to the FSB plenary, and publication of the agreed reports.

[13] Himino Ryozo, Introductory Remarks at the FSB Virtual Meeting on Policy Responses to COVID-19, 26 May 2020

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risks are you particularly worried about? Liquidity, solvency or operational risks? Under a range of scenarios, how can the official sector ensure financing to the economy, financial stability, and eventually, a strong recovery? How should we take into account intertemporal trade-offs and macroprudential effects arising from the feedback loop between the various segments of the financial system and the real economy? What roles should stress tests play?

The official sector side is represented today by central banks, regulatory authorities, finance ministries, the Basel Committee on Banking Supervision, the Committee on Payments and Market Infrastructures, the International Association of Insurance Supervisors and the International Organization of Securities Commissions. We are keen to hear your inputs to better discharge our policy work so that the efforts by the private and official sectors will work together well to help overcome the pandemic and ensure strong recovery.

Countries face different pandemic conditions, and the regulatory responses need to be tailored. The ultimate responsibility to protect the lives of the nation lies in the national governments, and I thought that international organizations should refrain from excessively constraining national governments' crisis management responses. At the same time, the past achievements in global regulatory reforms and convergence should not be surrendered.

The SRC started a soft coordination mechanism to support national authorities to take into consideration other authorities' responses in designing their own by gathering response information from members on a real-time basis and weekly sharing compiled information.

The five principles mentioned in the introductory remarks above accommodate temporary deviations from international standards unless they compromise core regulatory objectives while referring to the timely elimination of deviations.

To provide useful input to the formulation of national responses, the SRC attempted to make its agenda as forward-looking as possible. The introductory remarks, which were given right after the stabilization of the March liquidity crisis, already refer to a potential solvency crisis and a post-pandemic economic recovery. Specifically, the SRC agenda included: (1) compilation and analysis of national stress testing practices, (2) consideration of when and how to unwind emergency measures, (3) coordination between supervisory and resolution authorities, and (4) ways to mitigate debt overhang and to deal with zombie corporations.

As a result of the discussion on the item (2) above, the FSB published a report titled "COVID-19 Support Measures: Extending, Amending and Ending" in April 2021. The G20 ministers and governors welcomed the report in their communique.

At the time of the report, the second wave of the COVID 19 infection was growing and the report discussed extending and amending of support measures as well as ending. Particularly, on the choice of the timing of ending support measures, the report argues:

[W]ithdrawal of support measures before the macroeconomic outlook has stabilised could be associated with significant immediate risks to financial stability. At the same time, financial stability risks may gradually build if support measures remain in place for too long. On balance, most authorities believe that premature withdrawal of support could inflict more damage to the economy than maintaining support for too long.

The report also points out that authorities have a number of options for managing these trade-offs and may follow a flexible, state-contingent approach. Authorities may choose to adjust and

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withdraw support measures gradually by (1) ensuring that measures are targeted to those most affected, (2) requiring beneficiaries to opt in to receive support rather than automatically, (3) making the terms on which support is provided progressively less generous, and (4) sequencing the withdrawal of support measures rather than withdrawing all at once.

The report maintains that clear, consistent, and timely communication about policy intentions can help reduce risk of surprises and abrupt adjustments in financial markets and the costs associated with withdrawal of support.

The discussion of the agenda item (4) above resulted in the FSB's publication of a discussion paper titled "Approaches to Debt Overhang Issues of Non-Financial Corporates" in February 2022. The paper was produced by a team of interested SRC members chaired by Toshiyuki Miyoshi and participated by Hiroaki Otsuki, both members of JFSA.

The discussion paper maintains that the debt overhang of nonfinancial companies could result in underinvestment by viable companies, misallocation of resources to unviable companies, and lower productivity due to loss of entrepreneurial capacity. These could result in a drag on the economic recovery and pose risks to the financial stability.

To address these risks, the discussion paper discusses (1) how to assess companies' viability in the context of COVID-19, (2) how to facilitate timely restructuring of viable companies and the exit of unviable companies; and (3) how to manage the debt restructuring of a large number of small- and medium-sized enterprises and micro-companies.

As noted, the solvency crisis or the issue of excessive debt has not materialized in the manner initially feared. Responses to debt overhang issues, however, will significantly affect the post-pandemic medium-term economic growth paths. The discussion paper, with rich examples of national practices, will help national authorities design their own responses.

6――In retrospect

The COVID-19 pandemic has seen many waves and lasted much longer than many had initially anticipated. Neither a second liquidity crisis nor a solvency crisis, however, has occurred.

The firefighting toolbox the central banks developed to fight the GFC proved effective in containing the liquidity crisis and preventing its recurrence.

A solvency crisis has not occurred partly because the manufacturing sector recovered in late 2020 and early 2021. In addition, government grants, subsidies, and guarantees mitigated borrowers' worsening financial condition. The post-GFC regulatory reforms enhanced the resilience of financial institutions and made it possible for them to continue to support the economy. Regulatory responses with unprecedented speed, scale, and scope should also have contributed to the continued functioning of the financial system. The COVID-19 shock, however, has revealed the inadequacy of past regulatory reforms on nonbank financial intermediation.

In the past, regulators tend to focus on policies required to ensure financial stability against endogenous credit and business cycles. The pandemic caused regulators to focus on an exogenous shock. The risk of exogenous shocks, including climate changes, earthquakes, further pandemics, cyberattacks, and geopolitical incidents, would persist. The global policymakers' responses to the COVID-19 shock will be referred to as a precedent in future cases of exogenous shocks.

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