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Top 10 risk and compliance related news stories and world events that (for better or for worse) shaped the week's agenda, and what is next

Dear members and friends,

We have *another* definition for the term *vulnerability*.

According to the Financial Stability Board, a vulnerability is a property of the financial system that:
(i) reflects the accumulation of imbalances,
(ii) may increase the likelihood of a shock, and
(iii) when acted upon by a shock, may lead to systemic disruption.

According to the National Institute of Science and Technology (NIST) and the US Committee on National Security Systems (CNSS), *vulnerability* is a weakness in an information system, system security procedures, internal controls, or implementation that could be exploited by a threat source.

According to the National Industrial Security Program (NISP) that was established by Executive Order 12829, *Acute Vulnerability* is the vulnerability that puts classified information at imminent risk of loss or

compromise, or that has already resulted in the compromise of classified information. Acute vulnerabilities require immediate corrective action. *Critical Vulnerability* is an instance of National Industrial Security Program Operating Manual (NISPOM) non-compliance vulnerability that is serious, or that may foreseeably place classified information at risk or in danger of loss or compromise.

According to the Department of Homeland Security (DHS) Risk Lexicon, *vulnerability* is a physical feature or operational attribute that renders an entity open to exploitation or susceptible to a given hazard.
The DHS Risk Lexicon gives an extended definition too: *Vulnerability* is a characteristic of design, location, security posture, operation, or any combination thereof, that renders an asset, system, network, or entity susceptible to disruption, destruction, or exploitation.

In all my professional life, I try to build a *culture of vulnerability awareness* for organizations and companies. Every time I find another different definition of the word vulnerability, I know that we fight an uphill battle, and we have to struggle against very unfavourable circumstances.

Read more at number 1 below. Welcome to the Top 10 list.

Best regards,

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Number 1

FSB Financial Stability Surveillance Framework

The assessment of vulnerabilities affecting the global financial system is a core mandate of the FSB. Identifying material vulnerabilities facilitates monitoring by relevant public authorities and the preparation of policy actions to mitigate the financial stability risks posed by the vulnerabilities.

This report describes the framework used by the FSB to identify and assess global financial system vulnerabilities.

The framework has recently been revised following the conclusion of work to enhance the FSB's financial stability surveillance.

The purpose of the new framework is to increase the effectiveness of the FSB's vulnerabilities discussions, and improve the timeliness with which the discussions identify challenges to global financial stability.

The new surveillance framework aims to identify vulnerabilities in a proactive and forward-looking manner. It is based on systematic analysis that spans all parts of the global financial system.

To serve the international remit of the FSB, the new framework provides a global, cross-border, and cross-sectoral perspective on current vulnerabilities that draws on the collective perspective of the FSB's broad membership.

At the same time, the framework aims to capture new and emerging vulnerabilities in an evolving global financial system.

The framework embodies four key principles: focus on vulnerabilities that may have implications for global financial stability; scan vulnerabilities systematically and with a forward-looking perspective, while preserving flexibility; recognise differences among countries; and leverage the comparative advantages of the FSB while avoiding duplication of work.

The framework includes a common terminology – which defines key concepts such as vulnerabilities, shocks and resilience – as well as a common taxonomy of vulnerabilities.

Providing a common basis for discussion, these elements aid shared understanding and consensus building around the identification and assessment of vulnerabilities in the FSB.

The framework focuses on vulnerabilities, the accumulation of imbalances in the financial system, as opposed to the shocks that may trigger those vulnerabilities.

The framework also emphasises vulnerabilities that are common across countries or that may engender cross-border spillovers, which could interact with other vulnerabilities. However, in the event of a material shock, the approach has the flexibility to respond to the stress at hand while maintaining the surveillance of vulnerabilities.

The time horizon over which vulnerabilities materialise is important for policy, and therefore the framework also explicitly identifies global vulnerabilities that are currently material, those that may become material in the next 2 to 3 years, and those that may become material over a longer horizon.

The framework places particular emphasis on bringing multiple perspectives to bear in the assessment of current and emerging vulnerabilities.

Accordingly, the framework draws on the collective perspective of the FSB's broad membership and utilises several different sources to build a picture of vulnerabilities.

These sources include: analysis of surveillance indicators; regular surveys of FSB members and regional bodies; ongoing analysis by relevant FSB working groups; and periodic outreach to private sector participants. Drawing conclusions from these key inputs necessarily requires considered judgment.

Resilience, the capacity of the financial system to absorb shocks, is a vital concept for assessing vulnerability.

Gauging resilience enables the picture of gross vulnerabilities to develop into a view on material net vulnerabilities, and on the stability of the financial system.

Enhancing resilience assessments will be an ongoing priority of the FSB. Once identified, material global net vulnerabilities should be subject to more intensive monitoring and analysis, and, as appropriate, policy dialogue among FSB committees.

In addition, communication with the public about identified vulnerabilities offers important benefits. However, the FSB relies on a frank and open

exchange among its members to fulfil its mandate and the external communication should not inhibit this.

Therefore, the external communication will focus on the key messages from the internal vulnerabilities assessment.

These messages will be included in future FSB Annual Reports and could also be communicated in other formats, for example in notes to the G20.

Glossary of Terms

The **global financial system** consists of financial intermediaries, markets, and instruments as well as infrastructure that supports their activities. It also includes participants such as central banks and regulatory authorities, as well as providers of services that support financial activities.

Financial stability is the capacity of the global financial system to withstand shocks, containing the risk of disruptions in the financial intermediation process and other financial system functions that are severe enough to adversely impact the real economy.

A **shock** is an event that may lead to disruption or failure in part of the financial system.

A **vulnerability** is a property of the financial system that:
(i) reflects the accumulation of imbalances,
(ii) may increase the likelihood of a shock, and
(iii) when acted upon by a shock, may lead to systemic disruption.

Propagation mechanisms are the channels through which financial vulnerabilities cause disruption, given the occurrence of a shock.

Resilience is the capacity of a financial system to absorb shocks and prevent them from leading to an unravelling of the accumulated imbalances.

To read more: https://www.fsb.org/wp-content/uploads/P300921.pdf

Number 2

Reports on July and August Actions - Fighting COVID-19 Disinformation Monitoring Programme

The Commission published the latest reports that platform signatories of the Code of Practice on Disinformation issued about their ongoing efforts to limit COVID-19 and vaccine disinformation. As the Programme switched to a bimonthly reporting, the actions reported today cover the months of July and August.

The reports are delivered in the context of the COVID-19 disinformation monitoring programme set up under the 10 June 2020 Joint Communication. You may visit:
https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1006

https://ec.europa.eu/commission/presscorner/detail/en/ip_21_2585

European Commission - Press release

Coronavirus: EU strengthens action to tackle disinformation

Brussels, 10 June 2020

Today, the Commission and the High Representative are assessing their steps to fight disinformation around the coronavirus pandemic and are proposing a way forward. This follows the tasking by European leaders in March 2020 to resolutely counter disinformation and reinforce resilience of European societies. The coronavirus pandemic has been accompanied by a massive wave of false or misleading information, including attempts by foreign actors to influence EU citizens and debates. The Joint Communication analyses the immediate response and proposes concrete action that can be quickly set in motion.

European Commission - Press release

Commission presents guidance to strengthen the Code of Practice on Disinformation

Brussels, 26 May 2021

Today, the Commission publishes its guidance on how the Code of Practice on Disinformation, the first of its kind worldwide, should be strengthened to become a more effective tool for countering disinformation.

It sets out Commission expectations, calls for stronger commitments by the signatories and foresees a broader participation to the Code. Based on a robust monitoring framework and clear performance indicators, signatories should reduce financial incentives to disinformation, empower users to take an active role in preventing its spread, better cooperate with fact-checkers across EU Member States and languages, and provide a framework for access to data for researchers.

The results of the COVID-19 Disinformation Monitoring Programme are also feeding into the revision of the Code of Practice on Disinformation, in particular into the design of the monitoring framework for the strengthened Code.

Fighting COVID-19 vaccines disinformation

Platforms report on their updated policies and initiatives to reduce the spread of COVID-19 vaccines disinformation in July and August, for example:

- **Twitter** reports about updating its Public Service Announcement (PSA) carousels, which appear on top of users feed with new content and more information on COVID-19 variants. The COVID-19 vaccines PSA prompt directs people to country-specific Twitter Moments containing authoritative information around COVID-19 vaccines. Also, Twitter launched a pro bono promoted feature in France that appears in "trends" to support the vaccination campaign during the fourth wave of COVID-19, which received 11.2 million impressions and 20.2K engagement.

- **TikTok** introduced a new tool called "TopView" positioning, meaning that the videos placed in this category appear when users open the app and they are sound-on videos with full screen cover. TikTok reports offering this tool to the French government vaccination campaign in August, which generated 9 million impressions, combined with President Macron directly answering users questions on the channel. TikTok reports that videos tagged with the COVID vaccine tag steadily increased across Europe, increasing from to 114368 in June to 124851 in July and 130892 in August.

- **Microsoft** keeps on showing a vaccine tracker on Bing, indicating the progress of vaccination in individual countries and globally. LinkedIn's official page on COVID-19 and vaccines is regularly updated to provide authoritative information and prevent misinformation on vaccines. In July and August, the coverage has been extended to include official information about vaccines and vaccination, about vaccination being opened to teenagers in France and about vaccination within companies in Italy.

- **Google** are now expanding access for government organisations to promote COVID-19 content compliant to Google's Personalised Advertising Policy, including general COVID-19 vaccine information and updates on the latest COVID-19 protocols. YouTube publicly announced in September that it will ban all anti-vaccine

misinformation. As the announcement was not included in the current report, we are looking forward to reading further details on it in the next instalment of the reports.

- **Facebook** reports that in July it has extended its previous partnership in France to provide educational videos to combat COVID-19 misinformation. The campaign launched five new educational videos about applications, tools, tips and methods to help verify information, also in the form of videos and images, and conduct online research.

Further reporting for July and August

The reports provide further information illustrating actions taken to fight COVID-19 related disinformation and the impact of these actions through July and August 2021.

Some examples from the reports:

- **Twitter** reports launching a collaboration with Reuters and the Associated Press (AP) in August. Seeking to elevate credible information in real time in emerging conversations, the collaboration will increase the amount of contextual information provided to users on trending issues. The partnership will initially focus on English-language content.

- **TikTok's** report shows that while the number of videos tagged with the Vaccine tag keep on increasing, the number of videos with just the COVID tag drop to 1661 in July and 1261 in August.

- **Microsoft** reports that the Bing COVID experience had 2400084 views in the EU in July, in line with the June numbers, and an almost 50% increase in August (4710491 views, + 2310407 compared to July). The report shows that in July Microsoft Advertising reaching users in the EU had a huge drop in the number of ads blocked for violating its ads policies (including on COVID-19 and vaccines), falling to 286485 (-1297396 from June). In August the trend reversed, with 5448845 ads blocked for violating Microsoft advertisings policies, the highest since the beginning of the COVID-19 Disinformation Monitoring Programme.

- **Google** reported taking action against 16479 URLs on AdSense in July and August, an increase compared to June (+1584), with the most remarkable increase in actions taken in France (+1003 compared to June). At the same time, the number of ads and ad accounts rejected for violation of COVID advertising policies are in line with those reported in July, with a small increase in blocked accounts (+10).

- **Facebook** reports that during the month of July over 110000 pieces of content in the EU were removed for violating COVID-19 and vaccine misinformation policies on Facebook and Instagram (+ 34000 compared to June). In August, this number increased (+ 40000 compared to July), reaching over 160000 pieces of content.

To read more:
https://digital-strategy.ec.europa.eu/en/library/reports-july-and-august-actions-fighting-covid-19-disinformation-monitoring-programme

Number 3

Goodbye to All That: The End of LIBOR

Vice Chair for Supervision Randal K. Quarles, at The Structured Finance Association Conference, Las Vegas, Nevada

Now that business travel has started to pick back up as we emerge from the COVID event, a prosaic but insistent problem has reappeared: what to read on a long plane flight.

Like most of you, I try to get some work done—but, also like most of you, out of an amalgam of security concerns and indolence, I often don't succeed.

Something must improve the hours, but Kant is a little heavy, P.G. Wodehouse a little light, and T.S. Eliot looks like you're just showing off.

So, over the last few weeks, I've been re-reading Joan Didion while making my way from point A to point B: Slouching Toward Bethlehem, The White Album, and Where I Was From.

As it turns out, Joan Didion is a particularly apt author to be reading on the way to this conference—not because the conference is being held in Las Vegas, although her four-page summation of this "most extreme and allegorical of American settlements" is a classic.

But rather, because a nearly constant theme of her writing is change: how hard it is to recognize that things have changed; how hard it is to come to terms with it once recognized; how insistent people can be that surely, they will be OK.

And given that introduction, I'm sure you have now guessed what I intend to talk to you about today: LIBOR, the benchmark formerly known as the London Interbank Offered Rate.

LIBOR was the principal benchmark used to set interest rates for a vast number of commercial loans, mortgages, securities, derivatives, and other products.

For a number of years—certainly at least since July of 2017, and really for several years before—it has been clear that LIBOR would end, but some believed it was not clear exactly when LIBOR would end.

And, as a result, many market participants have continued to use LIBOR as if that end date would surely be in some indefinitely distant future, as if LIBOR would remain available forever.

Earlier this year, however, things changed, and changed significantly. Two things happened which together make clear that LIBOR will no longer be available for any new contracts after the end of this year, just 86 days from now.

First, the United Kingdom's Financial Conduct Authority (FCA), which regulates LIBOR, and ICE Benchmark Administration (IBA), which administers LIBOR, announced definitive end dates for LIBOR. No U.S. dollar LIBOR tenors will be available after June 30, 2023.

So, now there was a definitive and immovable date fixed for the end of LIBOR. However, the second thing that happened made clear that long before that end date in 2023, LIBOR would not be available for any new contracts after the end of this year.

Following the FCA and IBA announcements about the end of LIBOR, the Federal Reserve and other regulators published guidance making clear that we will focus closely on whether supervised institutions stop new use of LIBOR by the end of this year—86 days from now.

If LIBOR will not be available for new contracts, what is the point of IBA continuing to provide USD LIBOR quotes until mid-2023? Those LIBOR quotes will allow many existing contracts to mature according to their terms, thus greatly reducing the costs and risks of this transition.

Otherwise, many banks would have had to re-negotiate hundreds of thousands of loan contracts before December 31, an almost impossible task. But the whole process only works if no new LIBOR contracts are written while the legacy contracts are allowed to mature. So, those new LIBOR contracts will not be made. Change is difficult, but it is inescapable.

What is LIBOR, and Why is it Going Away?

LIBOR was intended to be a measure of the average interest rate at which large banks can borrow in wholesale funding markets for different periods of time, ranging from overnight to one month, three months, and beyond.

LIBOR is an unsecured rate, which means that it measures interest rates for borrowings that are made without collateral and therefore include some credit risk.

At first blush, it may seem peculiar that a borrowing rate for banks in London has been used so widely.

Why, for example, are more than $1 trillion of residential mortgages in the United States tied to LIBOR?

The answer is that, over time, LIBOR's pervasiveness became self-reinforcing.

Lenders, borrowers, and debt issuers relied on LIBOR because, first, everyone else used LIBOR, and second, they could hedge their LIBOR exposures in liquid derivatives markets.

Today, USD LIBOR is used in more than $200 trillion of financial contracts worldwide.

Federal Reserve officials have described LIBOR's flaws on numerous occasions.

The principal problem with LIBOR is that it was not what it purported to be. It claimed to be a measure of the cost of bank funding in the London money markets, but over time it became more of an arbitrary and sometimes self-interested announcement of what banks simply wished to charge for funds.

That might not have become such a debacle had it been clear to everyone what the ground rules were, but the ground rules for LIBOR were anything but clear.

As a result of subsequent changes to the process, LIBOR panel banks now provide evidence of actual transactions where possible.

A fundamental problem, however, is that LIBOR has been unable to separate itself from its perception as a measure of bank funding costs, yet the market on which LIBOR is based—the unsecured, short-term bank funding market—dwindled after the 2008 financial crisis.

This means that, for many LIBOR term rates, banks must estimate their likely cost of such funding rather than report the actual cost.

Many LIBOR panel banks are uncomfortable estimating their funding costs in producing a benchmark perceived by many to measure actual funding costs.

As a result, the great majority of the panel banks have determined that they will not continue participating in the process. This is why the FCA and IBA have announced definitive end dates for LIBOR.

I should note here that regulators have warned about LIBOR-related risks for many years. Beginning in 2013, the U.S. Financial Stability Oversight Council and the international Financial Stability Board, which I currently chair, expressed concern that the decline in unsecured short-term funding by banks could pose serious structural risks for unsecured benchmarks such as LIBOR.

To mitigate these risks and promote a smooth transition away from LIBOR, the Federal Reserve convened the Alternative Reference Rates Committee (ARRC) in November 2014.

As I will describe further in a moment, the ARRC has worked to facilitate the transition from LIBOR to its recommended alternative, the Secured Overnight Financing Rate (SOFR).

To read more:
https://www.federalreserve.gov/newsevents/speech/quarles20211005a.htm

Number 4

SEC Highlights Investor Protection for World Investor Week 2021

The Securities and Exchange Commission has announced that it will highlight investor education and protection resources during World Investor Week 2021 (WIW). You may visit: https://www.investor.gov/additional-resources/spotlight/world-investor-week

This marks the fifth year of WIW, a global effort promoted by the International Organization of Securities Commissions (IOSCO) that brings together regulators on six continents to raise awareness about the importance of investor education and protection.

The SEC is once again serving as the national coordinator in the U.S. working with the U.S. Commodity Futures Trading Commission, Financial Industry Regulatory Authority, National Futures Association, and North American Securities Administrators Association.

Together with these organizations, the SEC's Office of Investor Education and Advocacy (OIEA) issued a joint Investor Bulletin today to promote WIW's key messages. You may visit: https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-bulletins/key-topics

Investor education and protection resources are available at Investor.gov.

During WIW, SEC staff will host outreach events on the benefits of investing early, making informed investment decisions, creating an investment plan, and understanding the risks and fees associated with investments; conducting a background check on an investment professional; recognizing the power of compounding interest; and learning how to avoid fraud.

"Investor protection is at the core of the SEC's mission, and we are proud to serve as the national coordinator in the U.S. for World Investor Week," said SEC Chair Gary Gensler. "We especially hope to reach younger investors, first-time investors, and investors in underserved communities. As markets and technology evolve, more investors than ever are able to access our capital markets. I encourage investors at every stage to take advantage of

resources available at Investor.gov and ongoing outreach events in communities across the country."

For the first time ever, Chair Gensler issued a WIW kick-off video underscoring the importance of this global initiative, and created a new "Office Hours with Chair Gensler" video about the basics of investing that will be published on his Twitter page on Wednesday.

Through his new "Office Hours" videos, Chair Gensler speaks directly and plainly to America's investors on timely topics, such as digital engagement, cryptocurrencies, climate risk disclosure, and risks involving investing in China and off-shore shell companies.

The SEC's World Investor Week page highlights a "Term of the Day" along with corresponding video clip with definitions about microcap stocks, day trading, ESG (environmental, social, governance) investing, fractional shares, margin accounts, special purpose acquisition companies (SPACs), and index funds.

On the same webpage, investors can access an investing quiz to test their knowledge of the "Term of the Day" and other key messages and themes from WIW. In addition, staff will highlight the importance of thoroughly researching and understanding the risks of online investing and investing in digital assets.

"Knowledge is power, and the best way to protect yourself is to learn investing basics, understand the risks involved with every investment opportunity, and create a long-term plan that best meets your financial goals," said Lori Schock, Director of the SEC's Office of Investor Education and Advocacy. "It's especially important for first-time investors to take advantage of the online resources on Investor.gov. It's a great first step toward protecting your money and learning how to build a smart saving and investing plan for your financial future."

For WIW, Ms. Schock posted a new Director's Take article, "Taking Stock in Teen Trading." that speaks directly to parents and teens about the importance of forming a parent/teen investment partnership early on. In the article, she discusses topics such as teen trading accounts, social media influence, and apps.

Through her Director's Take articles, Ms. Schock provides investors with helpful information on timely topics.

SEC staff WIW outreach events include:

- Saving and investing presentations and webinars for diverse communities nationwide, libraries, students, teachers, seniors, and military service members;

- Presentations to college students, including an event with students from Historically Black Colleges and Universities (HBCUs) in which students will be able to ask questions of Chair Gensler;

- A Facebook Live event with AARP;

- Radio interview with Lori Schock on topics important to seniors; and

- Thrift Savings Plan (TSP) program for federal employees.

To see a list of other SEC outreach activities or learn more about WIW, please visit the SEC's World Investor Week page at: https://www.investor.gov/additional-resources/spotlight/world-investor-week

Investor.gov
U.S. SECURITIES AND EXCHANGE COMMISSION

Number 5

EBA Risk Dashboard points to stabilising return on equity in EU Banks but challenges remain for those banks with exposures to the sectors most affected by the pandemic

- In Q2 2021, banks' return on equity (RoE) remained at levels similar to Q1, not least due to low impairments.
- Capital and liquidity ratios remained strong.
- While the non-performing loan (NPL) ratio declined, asset quality of loans under moratoria and public guarantee schemes (PGS) further deteriorated.
- Cyber and information and communication technology (ICT) related risks remained high.

The European Banking Authority (EBA) published its Risk Dashboard for the second quarter (Q2) of 2021.

The data indicate that banks are benefitting from the economic recovery with RoE remaining broadly similar to the previous quarter.

Capital ratios remained stable and there was a further decline in NPL ratios. Operational risks remain elevated mainly due to cyber and ICT related risks.

Profitability was roughly stable. RoE decreased to 7.4% in Q2 2021 from 7.7% in the previous quarter, with the lower end of the 5th percentile moving further into negative territory.

On average, banks benefitted from the economic recovery, not least resulting in lower impairments and a rise in fee and commission income.

Net interest income did not show any major benefit from positive economic developments, and the net interest margin (NIM) remained stable at 124bps.

There are indications of rising operating expenses amid a resumption of pre-pandemic working arrangements, including a return to the office, resumption of some business travels, and similar measures.

Banks maintained strong capital levels. The average CET1 ratio remained unchanged at 15.5% on a fully loaded basis in Q2 2021, amid a parallel rise in CET1 capital and risk weighted assets (RWA).

The leverage ratio increased from 5.6% in Q1 2021 to 5.7% in Q2 2021 on a fully loaded basis, reflecting higher capital as well as a slight decrease of total assets during the quarter.

The Liquidity Coverage Ratio (LCR) remained high. LCR declined from 173.6% in Q1 to 172.4% in Q2 2021. Its dispersion shows that the lower end of the LCR's 5th percentile remains well above 100%.

The contraction of the loan to deposit ratio continued, reaching 108.9% in Q2 (110.9% in Q1) due to a strong increase in client deposits.

Overall, the latter increased, but with diverging trends for households and non-financial corporates (NFC).

On the other hand, deposits from households continued their rising trend while NFC deposits declined.

The relatively strong increase in the asset encumbrance ratio during the previous quarter flattened again, slightly rising from 28.8% as of Q1 to 29.1% in Q2 2021.

The aggregate NPL ratio continued to decline, reaching 2.3% at end Q2. Due to the uneven impact of the pandemic on corporates, sector level data confirms increasing divergence of asset quality.

For accommodation and food services, the NPL ratio rose further from 9% to 9.6% quarter on quarter (QoQ) and for arts, entertainment and recreation from 7.9% to 8.2%.

Forborne loans increased further and were up by 3.7% in Q2. The forbearance ratio rose accordingly by 10 bps to 2.1% in Q2. The stage 2 ratio declined from 9.0% to 8.8% QoQ.

Asset quality of exposures under moratoria and PGS deteriorated further. Whereas loans under existing EBA eligible moratoria declined by EUR 80bn in Q2 to EUR 123.4bn, PGS loans remained roughly stable at around EUR 377bn.

The NPL ratio increased from 3.9% to 4.5% for loans under current moratoria, from 4.5% to 4.7% for loans under expired ones and from 1.4% to 2.0% for PGS loans.

In Q2 2021, the share of stage 2 loans increased by 1p.p. to 28.2% for loans currently under moratoria, while it reached 24.4% (up from 23.6% in the previous quarter) for loans with expired moratoria. For PGS exposures it increased from 13.6% to 18.5%.

Cyber and ICT related risks remain elevated even though no major successful cyber-attack has been reported. Amid higher levels of online banking and remote working as well as increased reliance on third party providers, banks' ICT systems remain vulnerable to significant disruptions in their operations.

Conduct-related risks remain high too, stemming from areas like COVID-19 support measures or the upcoming LIBOR and EONIA replacements. In addition, inadequately addressed environmental, social and governance (ESG) factors and considerations can impact institutions' counterparties or invested assets and increase conduct risk.

To read more:
https://www.eba.europa.eu/sites/default/documents/files/document_library/Risk%20Analysis%20and%20Data/Risk%20dashboard/Q2%202021/1021365/EBA%20Dashboard%20-%20Q2%202021.pdf

https://www.eba.europa.eu/sites/default/documents/files/document_library/Risk%20Analysis%20and%20Data/Risk%20dashboard/Q2%202021/1021367/KRI%20-%20Risk%20parameters%20annex%20-%20Q2%202021.pdf

Number 6

The long and short of it: A balanced vision for the international monetary and financial system

Tiff Macklem, Governor of the Bank of Canada, Governor Council on Foreign Relations, Washington, D.C.

Introduction

Thank you for your kind introduction. I'm very pleased to be here with you, virtually at least. I look forward to the day when we can meet in person again. But the need to invest in international cooperation can't wait. And I know we'll have some thoughtful and engaging conversation despite the virtual format.

My hope is that we can take inspiration from the cooperation among researchers who developed effective vaccines against COVID-19 in record time. Their efforts and collaboration are saving lives and livelihoods and are underpinning the global economic recovery. This is international cooperation at its very best.

Tragically, there hasn't been nearly as much success in ensuring the equitable global distribution of vaccines, especially to developing countries. This is the biggest health and economic risk facing the world, and—as the G20 highlighted in July—governments and the private sector must work together to make vaccines available to all.

While global public health is the most urgent challenge for international cooperation, the international monetary and financial system is one of the most enduring. August marked the 50th anniversary of the end of the Bretton Woods system of fixed exchange rates. Canada exited early, moving to a floating exchange rate in 1970.

That was a year before the United States suspended convertibility of the US dollar into gold and most major countries floated their exchange rates. This anniversary provides a timely occasion to reflect on the international monetary and financial system that has emerged—and how well equipped it is to deal with the challenges ahead.

This global system—the exchange rate and capital accounts as well as the institutions and rules that govern them—affects everyone and is critical to our shared prosperity.

The investments we have made collectively to strengthen the system have allowed us to clear some hurdles. But we need a system that better balances the immediate imperatives of the short run with the important building blocks for longer-run prosperity. That's what I want to talk about today.

We aspire to an international monetary and financial system that favours inclusive and sustainable growth. In the long run, that is best achieved by a system that promotes economic integration—with free trade, open capital markets and flexible exchange rates.

But the current system isn't there yet, and while we aspire to the long run, we live in the short run. For both these reasons, policy-makers face a delicate balance.

Too much confidence that open markets will always deliver economic and financial stability increases the risk of volatile episodes that hurt jobs and growth. But too much focus on managing short-run pressures risks thwarting the medium- to long-run adjustments that are fundamental to productivity and rising standards of living.

Finding the right balance between managing short-run pressures and ensuring steady progress toward liberalization is the crucial task of the international monetary and financial system.

While much progress has been made in the 50 years since the end of Bretton Woods, achieving this balance remains elusive. And looking ahead, it will not get easier or less critical.

As the recovery from the pandemic progresses, and major economies begin to remove exceptional monetary stimulus, the system will likely come under more pressure.

Tighter financial conditions globally will suit some countries better than others. And beyond the pandemic recovery, new and even bigger challenges are on the horizon, including climate change, the digitalization of currencies and growing inequality.

In my time today, I'd like to talk about Canada's place in the global monetary and financial system. Then I'd like to highlight some of the challenges the system faces, particularly in the wake of the COVID-19 crisis. Finally, I'd like to outline our vision for the 21st century.

Canada and the global monetary and financial system

Cross-border economic integration has been a critical source of increased prosperity for Canadians and for citizens the world over. To be effective, the international system needs to deliver stability in prices and allow exchange rate movements that reflect fundamentals.

At the same time, it must be able to adjust to shocks and structural changes in a timely way. In Canada, we have long-standing experience with open capital accounts, inflation targeting and flexible exchange rates, and they have served us and a growing number of countries well.

Still, weaknesses in the arrangements and policies that make up the international monetary and financial system are long-standing. Over the past two decades, the Bank of Canada has emphasized the need for sound economic and financial policy frameworks in advanced and emerging-market economies (EMEs) and sound governance of our global institutions.

Progress has made the system better able to prevent and manage crises. The International Monetary Fund (IMF) has strengthened its surveillance, enhanced its financing facilities and developed a framework to guide the use of capital controls. Many EMEs have strengthened their policy frameworks, including the wider use of inflation targeting and greater exchange rate flexibility.

Financial regulation and supervision have been enhanced globally through the implementation of the Basel III reforms. Swap lines and reserve pooling between central banks—two elements of the global financial safety net—have expanded.

And advanced economies have also become more attuned to the spillovers their policies might cause.

This progress has helped the global economy weather the COVID-19 shock. But the crisis has also reminded us of the connectedness and fragility that are inherent in the system. As we all know, massive liquidity interventions by central banks were needed to restore market functioning and support the provision of credit.

The interconnections in the global financial system—across countries and between banks and non-bank financial institutions—have brought great benefits. But these interconnections can also propagate and amplify stress.

The test we faced together during the COVID-19 shock as well as the challenges that lie ahead underline the need to refocus our attention on where the system should be headed and how we get there. The fallout from the pandemic and the inevitable adjustments ahead as major regions recover at different speeds make dealing with these issues more urgent.

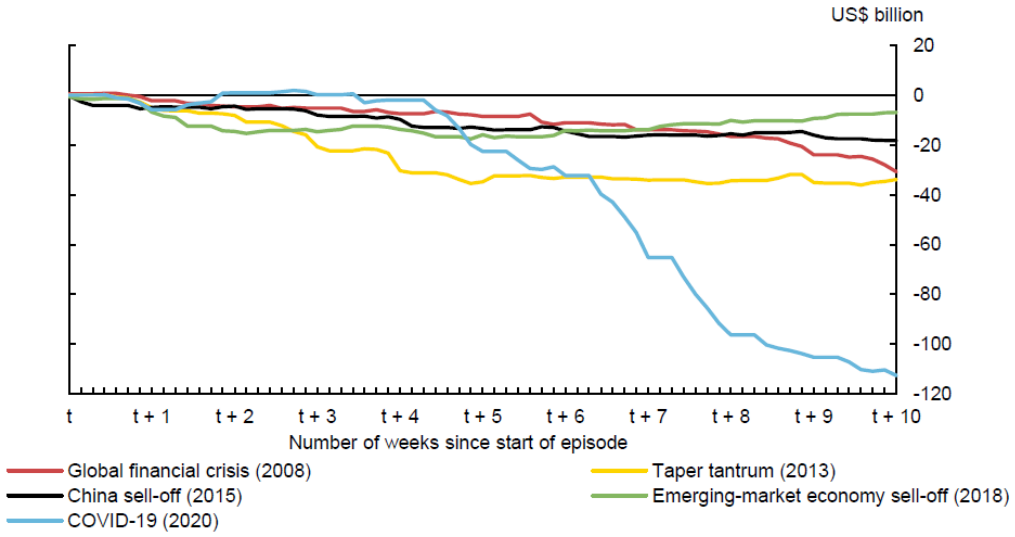
Challenges and issues facing the system

The current challenges facing our global system can be grouped into two categories: short-run pressures and longer-run challenges. Let me first talk about those short-run issues.

EMEs have continued to experience volatility in their financial conditions, despite improvements in fundamentals that have resulted in fewer full-fledged crises. In the last dozen years, episodes of global stress have been all too frequent: the global financial crisis in 2008–09, the taper tantrum in 2013, the sell-off in China in 2015 and the sell-off in emerging markets in 2018. The COVID-19 shock dwarfs these in global scale and reach. In March 2020, capital flew out of EMEs at a historic pace (Chart 1).

Chart 1: Portfolio flows to emerging-market economies declined sharply during COVID-19 compared with previous shocks

Cumulative daily non-resident portfolio flows to emerging-market economies



Sources: Institute of International Finance and Bank of Canada calculations

Last observation: April 3, 2020

While the situation has since stabilized, capital outflows could happen again when the largest economies start reducing the extraordinary stimulus put in place to deal with the pandemic.

To address similar circumstances, EME policy-makers have used a variety of measures, including restricting capital flows and intervening in foreign exchange markets. These policies have gained increased acceptance, and there are circumstances in which they are justified and can be effective in

managing short-run pressures. At the same time, these policy interventions can thwart or delay necessary adjustment in their economies and stunt the development of domestic financial markets and products.

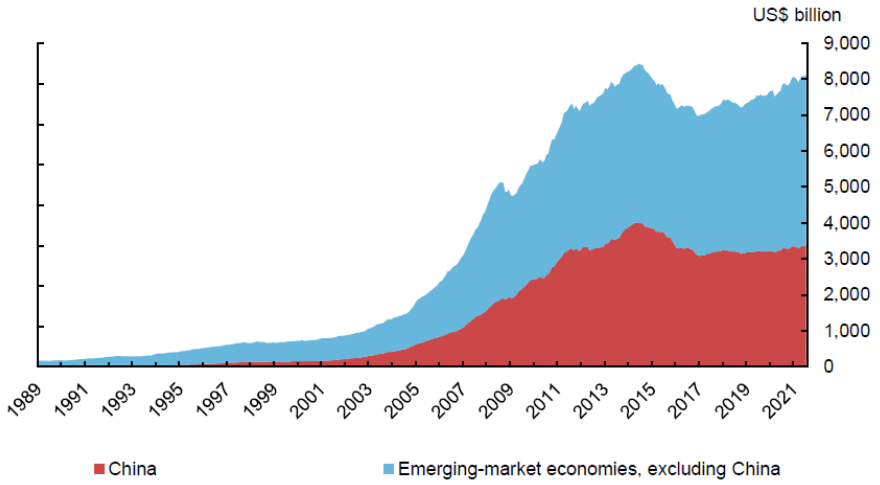
For example, the use of capital controls and foreign-exchange interventions—particularly the repeated use of them—can undermine the longer-run development of deep and liquid domestic financial markets.

Appropriate guardrails are required to ensure that short-run actions do not get in the way of needed development. Otherwise the short run can become the long run.

There is another knock-on effect. Faced with elevated volatility, EMEs are taking out more insurance by accumulating reserves (Chart 2).

Chart 2: Reserve holdings by emerging-market economies remain high

Official reserve assets (including gold)



Source: International Monetary Fund International Financial Statistics

Last observation: July 31, 2021

At a minimum, this self insurance looks globally inefficient. And this demand for reserves is contributing to a shortage of reserve assets, which may be reinforcing the decline in the neutral rate of interest. This in turn raises the risk of liquidity traps and can lead to the buildup of financial vulnerabilities everywhere.

Turning to longer-run challenges, there are several. The first involves the welcome evolution of countries from frontier to emerging to advanced economies. As these economies grow and increase in importance, their integration into the international monetary and financial system will become more pressing.

Early on, they may not have a well regulated and stable domestic financial sector, or open trade and capital markets that promote economic

integration. The international community needs to develop and invest in a clear long-run strategy to assist with the smooth integration of these countries into the global system and to encourage them to adopt the rules that guide this system.

A second longer-run challenge is the choice of exchange rate regime. We've seen how a freely floating exchange rate may lead to excess volatility in response to short-run disturbances.

But to accommodate longer-run structural changes that are essential for sustained development, some margin of flexibility is needed. If nominal exchange rates remain fixed, then domestic prices and wages have to adjust, and this can be protracted and painful.

In particular, if domestic prices and wages need to fall, this is likely to require an extended period of weak demand and high unemployment. In the medium run, the real exchange rate moves and the system adjusts, but the cost of forcing the adjustment through all wages and prices can be steep.

Worse still, if that adjustment is also hampered by capital controls, external imbalances are likely to persist and build. And if, as a result, the currency peg becomes unsustainable, the country is likely to face an abrupt adjustment, and the effects are often felt by the entire system.

Vision and agenda for the 21st century

As we consider these challenges together, the right balance is crucial. We need a vision for the international monetary and financial system of the 21st century in which EMEs will form an increasing share of the global economy, while gradually developing their financial systems.

This vision for the long run cannot merely focus on a utopian system where all participants have mature, well-regulated financial systems, fully open capital accounts and exchange rates that are freely floating.

We must also be mindful that some are closer to the destination than others. In discussing this vision, I want to focus on three priorities: the need to find balance between short-run policies and long-run progress, the value of a framework for currency intervention, and the need for global cooperation and resources.

Over the past decade, the focus has been on widening the set of policies countries use to deal with temporary external shocks. This is welcome and is reflected in the IMF's Institutional View. But there has not been enough

attention to ensuring that these policies do not impede longer-run progress. Many EMEs seem to be settling for intermediate exchange rate regimes with more or less regular foreign exchange interventions.

This risks slowing needed structural adjustments in the real economy. It also risks exacerbating the very pressures these short-run tools seek to manage. By thwarting adjustment, they can cause pressures to build up, leading to greater volatility.

Finding balance means allowing countries to respond to excess volatility or disruptions in the short run while making the system flexible enough to adjust in the long run. Progress has been made in the IMF's Institutional View, which supports the use of macroprudential policy to manage financial stability risks.

And only if macroprudential measures are insufficient, should capital flow management be considered. But more work is required to understand the implication of short-run policies for longer-run financial development.

Currency intervention needs attention as well. A freely floating currency may not provide as much benefit to some EMEs as once thought. Dominant currency pricing reduces the benefits of exchange rate adjustment for some countries, and currency mismatches on balance sheets increase the costs.

But the system needs guardrails to make sure currency intervention does not get in the way of needed relative price adjustments. At the Bank, we would like to see the development of a framework for exchange rate management similar to that in the IMF's Institutional View for capital flow management.

Such an agreed-upon framework could guide managed floating exchange rate regimes to make sure they do not stall adjustment in the medium to long run. The focus here should be on a coherence between the choice of exchange rate regime and other policies.

In the end, policy-makers need to recognize that capital account and currency interventions should be targeted to address specific concerns, and these interventions should be temporary.

Over the longer run, countries should plan to rely less on these policies as their financial systems mature. In the shorter run, every time these interventions are used, a clear exit plan should be in place.

And the circumstances under which interventions may occur should be well defined, so that an exit can be facilitated when conditions are no longer met.

Global cooperation and resources are also required to agree on a long-run vision for the international system. Considerable resources have been devoted to the management of short-term liquidity and volatility issues, and that has been necessary and important.

Global policy-makers need to balance this effort with greater focus and resources to promote longer-term economic and financial development.

The IMF's multilateral role in surveillance is essential—the global system needs to be managed as a system. And the Financial Stability Board is doing valuable work with peer review and assessments to strengthen adherence to international standards.

My hope is that we can build on these elements to deepen the engagement of systemically important economies on an international monetary and financial system that maximizes the benefits of economic and financial integration.

In Canada's experience, the destination is one with open capital markets, robust and transparent policy frameworks—including monetary, fiscal and macroprudential policies—and enough exchange rate flexibility to promote the timely and symmetric adjustment to shocks. Effective and legitimate multilateral institutions are essential to this destination.

To this end, continuing efforts to improve the governance of these institutions are important. This includes ensuring that IMF members are properly represented in their quota shares and there are transparent and clear roles and responsibilities for each level of decision-maker at the IMF.

Conclusion

Let me conclude here, so that we have enough time for a good discussion. I want to leave you with a sense of urgency and purpose.

The pandemic and the looming challenges ahead, including climate change and digital currencies, make it more important than ever that the international monetary and financial system evolves.

We need a clear long-run destination that everyone is committed to and a framework to manage short-run challenges in a way that doesn't derail us from that ultimate destination.

What we need is an international monetary and financial system that can handle—even facilitate—the transitions to come, including the exit from exceptional monetary policy, the transition to net zero emissions and the potential digitalization of the international monetary system.

I look forward to discussing all of these issues with you. Thank you.

Number 7

A taxonomy of sustainable finance taxonomies

BIS Papers, No 118, Torsten Ehlers, Diwen (Nicole) Gao, Frank Packer

Abstract

Sustainable finance taxonomies can play an important role in scaling up sustainable finance and, in turn, in supporting the achievement of high-level goals such as the Paris Accord and the UN sustainable development goals.

This paper develops a framework to classify and compare existing taxonomies. Several weaknesses emerge from this classification and comparison, including the lack of usage of relevant and measurable sustainability performance indicators, a lack of granularity and lack of verification of achieved sustainability benefits.

On this basis, the paper proposes key principles for the design of effective taxonomies.

The principles are then employed to develop a simple framework for transition taxonomies.

The key policy messages of the analysis are:

(i) Endeavor that taxonomies correspond to specific sustainability objectives;

(ii) Encourage the development of transition taxonomies and focus alignment with the objectives of the Paris Agreement;

(iii) Monitor and supervise the evolution of certification and verification processes; and

(iv) Shift to mandatory impact reporting for green bonds.

Executive summary

Scaling up sustainable finance is a key element in raising private financing to support the transition to a sustainable economy. How should taxonomies be designed to encourage financial flows to sustainable investments and support this transition in the most effective way?

Before delineating the crucial design features of taxonomies, it is important to establish what taxonomies are and what they are for:

A taxonomy for sustainable finance is a set of criteria which can form the basis for an evaluation of whether and to what extent a financial asset can support given sustainability goals. Its purpose is to provide a strong signal to investors, and other stakeholders, and assist their decision making – by identifying the type of information investors need to assess the sustainability benefits of an asset and to classify an asset based on its support for given sustainability goals.

Taxonomies can be classified along four key defining characteristics:

Objective. Which sustainability goals are supported?
Scope. Which activities/industries/entities are included?
Target. How is the purpose translated into a measurable target?
Output. What types of information are provided?

Comparing some major taxonomies across key markets for sustainable finance, the paper finds that existing taxonomies often mix several sustainability goals and provide output that could be more transparent and decision-useful for investors.

Key issues are the need for more use of relevant and measurable sustainability performance indicators, a lack of granularity and lack of verification of achieved sustainability benefits.

Based on the above findings, the paper develops five principles for designing effective taxonomies and employs those principles to develop a basic design for transition taxonomies – taxonomies that are in line with a transition to reduced carbon emissions consistent with the Paris accord.

The principles anticipate a rapidly increasing amount of available sustainability-related data going forward – enabled by increasing sustainability disclosures, collection of data from third parties, and technological innovation in collecting these data

To read more: https://www.bis.org/publ/bppdf/bispap118.pdf

Number 8

Solving Defense Optimization Problems with Increased Computational Efficiency

Program aims to develop Quantum-Inspired solvers to tackle complex defense optimization problems with 500X performance improvements

Department of Defense (DOD) must solve many complex optimization problems to enable mission capabilities - from determining the most efficient way to distribute supplies to minimizing warfighters' exposure to hostile forces.

Solving these intricate scenarios is difficult, largely owing to the limitations of existing computing resources.

Today, many optimization problems are solved on conventional computers running both heuristic and approximate algorithms, extracting the best solutions allowed by the limited time and energy that is available.

Many believe quantum computing could be the answer. While there are potential advantages to quantum information processing, there is not enough supporting evidence to show that a quantum solution would be suitable for the size, weight, and power limits of many DOD mission-relevant applications.

"That does not mean that valuable lessons cannot be learned from quantum techniques, and applied to classical computing," said Bryan Jacobs, a program manager in the Microsystems Technology Office. "DARPA seeks to do just that with a new program to develop Quantum-Inspired (QI) classical solvers. QI solvers are mixed-signal systems that use classical analog components and digital logic to emulate the physics of dynamic systems." These systems are projected to outperform both conventional and quantum computers by over a factor of 10,000.i

DARPA's Quantum-Inspired Classical Computing (QuICC) program seeks to leverage lessons learned from benchmarking quantum algorithms to develop QI solvers for a range of complex DOD optimization problems, and demonstrate the feasibility of reducing the required computational energy by at least two orders of magnitude over existing techniques.

To date, prototype QI solvers have been demonstrated using small, "boutique" problems tailored to existing architectures. To tackle larger scale, more DOD-relevant problem classes, the QuICC program must address multiple technical obstacles. These include analog hardware

challenges that restrict connectivity between dynamic systems, as well as the prohibitive growth in digital resources with problem size.

To overcome the challenges, the QuICC program seeks innovative solutions with algorithmic and analog hardware co-design, and application-scale benchmarking techniques. Researchers will work across two technical areas to achieve the target objectives.

The first area focuses on developing solver algorithms and creating a framework for assessing the potential performance of QI solvers. The second aims to develop QI dynamical system hardware as well as validated models of their performance.

Progress on QuICC will be measured against a set of key metrics, including computational efficiency, which is characterized by the energy expended to obtain a high-quality solution to a given problem.

QuICC prototype systems will target a 50X reduction in energy for intermediate problem sizes, and show the feasibility of a 500X reduction for mission-scale problem sizes.

"With QuICC, we want to create a fundamentally new way of doing classical computing that takes inspiration from the algorithmic advances happening in quantum computing. The goal is to enable a 500X performance improvement in the energy required to solve complex, DOD-relevant optimization problems.

If we're successful in generalizing and scaling QI solvers for DOD-relevant applications, we could see a quantum leap in computational efficiency for a broad range of optimization challenges," said Jacobs.

To learn more about the QuICC program and its objectives, please visit the Broad Agency Announcement published on SAM.gov

Number 9

Attackers look to deploy attacks through the software supply chain

Cloud services can be more secure than in-house solutions, but they aren't always without their own flaws.

An unnamed software-as-a-service (SaaS) provider invited researchers from Unit 42 at Palo Alto Networks to identity vulnerabilities in the supply chain. You may visit:
https://unit42.paloaltonetworks.com/cloud-threat-report-2h-2021/

The exercise uncovered critical software development flaws leaving customers potentially vulnerable to attacks similar to those on SolarWinds and Kaseya VSA.

The researchers were able to escalate their privileges from the limited access a contractor might be given, all the way to administrator access. From this position a real attacker would be able to compromise the system, with the company realising too late to take effective action.

Nathaniel Quist, principle researcher at Unit 42, said "Role-based access controls within the developer roles would have prevented the Unit 42 researchers from accessing all of the developer repositories".

In his blog post, There's a hole in my bucket, Nigel C talks about ways to secure data in the cloud, including the importance of setting identity (e.g. role) or resource-based policies for access. You may visit:
https://www.ncsc.gov.uk/blog-post/theres-hole-my-bucket

There's a hole in my bucket

...or 'Why do people leave sensitive data in unprotected AWS S3 buckets?'

In his 'My cloud isn't a castle' blog, Andrew A discussed the general challenge of preventing leaks from misconfigured cloud services. Here we look at a specific service which we've been asked about: Amazon Web Services (AWS).

It seems like every month there's a new announcement about an organisation suffering a data leak from an improperly-secured Amazon S3 bucket. Either the bucket was made public (exposing sensitive files to

anyone on the Internet), or was left open to any authenticated AWS user (anyone can sign up to AWS to become an authenticated AWS user).

However, there's not much public discussion about why so many buckets end up exposed. A first thought might be 'someone forgot to lock down the access'. However, S3 buckets - by default - can only be accessed by the bucket owner.

The owner must decide to make the bucket accessible, meaning data leaks are not due to users forgetting to lock them down. Something else must be going on....

It's not always good to share

While some data leaks may simply be a case of storing sensitive data in the wrong bucket, I suspect that many of these leaks are a consequence of S3 buckets being used as 'just another file storage system'.

Despite some superficial similarities, S3 is not a POSIX file system like Windows or UNIX, and assumptions based on POSIX file systems can mislead. Working with S3 without understanding how AWS works will lead to frustration and/or insecure data.

Access control for S3 buckets can be complex as it is implemented through two different systems: the older coarse-grained ACLs (Access Control Lists), and the newer 'IAM Policies'.

IAM policies are powerful and fine-grained (perhaps too fine-grained for purposes like simple file-sharing). For users unfamiliar with IAM (and its use of JSON) there's a steep learning curve, so it's perhaps not surprising when people on a tight timescale simply make the bucket public. Do any of these justifications sound familiar?

- 'It's only for a little while.'

- 'It's only for the demo. I'll look up the proper way to do it later.'

- 'Nobody will find it anyway.'

Unfortunately for these people:

- It's easy to forget to remove temporary permissions.
- It's easy to forget to implement correct protections when the demo transitions to a live system.

- People will find it: there are lots of people hunting for open buckets. It's sensible to assume that if a bucket is public, its contents have already been copied.

And, while 'world-readable' with local files really translates to 'readable by anyone on the system', with S3 buckets it's literal.

To read more: https://www.ncsc.gov.uk/blog-post/theres-hole-my-bucket

Number 10

Operation GhostShell: Novel RAT Targets Global Aerospace and Telecoms Firms

In July 2021, the Cybereason Nocturnus and Incident Response Teams responded to Operation GhostShell, a highly-targeted cyber espionage campaign targeting the Aerospace and Telecommunications industries mainly in the Middle East, with additional victims in the U.S., Russia and Europe.

The Operation GhostShell campaign aims to steal sensitive information about critical assets, organizations' infrastructure and technology.

During the investigation, the Nocturnus Team uncovered a previously undocumented and stealthy RAT (Remote Access Trojan) dubbed ShellClient which was employed as the primary espionage tool.

The Nocturnus Team found evidence that the ShellClient RAT has been under ongoing development since at least 2018, with several iterations that introduced new functionalities, while it evaded antivirus tools and managed to remain undetected and publicly unknown.

Assessments as to the identity of the operators and authors of ShellClient resulted in the identification of a new Iranian threat actor dubbed MalKamak that has operated since at least 2018 and remained publicly unknown thus far.

In addition, our research points out possible connections to other Iranian state-sponsored APT threat actors such as Chafer APT (APT39) and Agrius APT. However, we assess that MalKamak has distinct features that separate it from the other Iranian groups.

To read more:
https://www.cybereason.com/blog/operation-ghostshell-novel-rat-targets-global-aerospace-and-telecoms-firms

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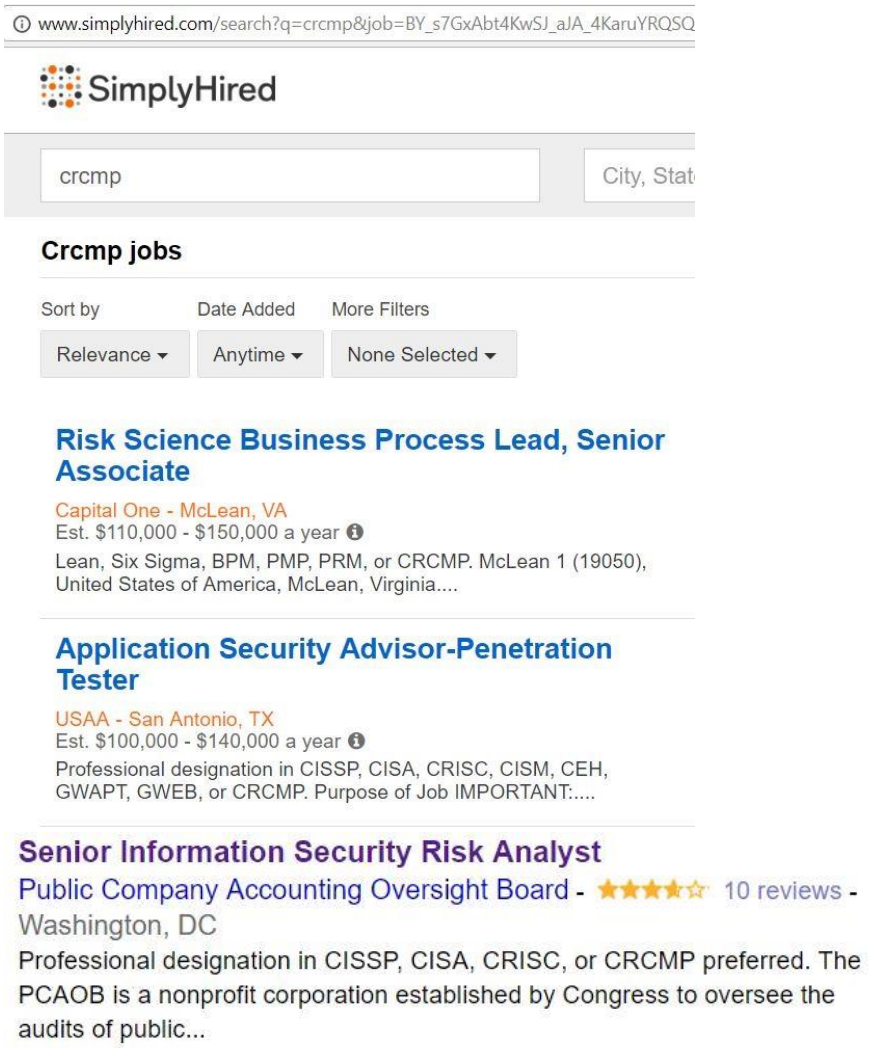

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