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Report of the Secretary-General

Summary

The present report, submitted pursuant to General Assembly resolution 74/202, provides a review of the global economic and financial impacts of the coronavirus disease (COVID-19) pandemic and the response of the international financial system. It contains proposals for strengthened international cooperation and a fuller mobilization of the international safety net in support of countries in need. The report consists of five main sections: (a) the impact of the pandemic on the global economy, financial markets and capital flows; (b) the international response to the crisis and financial safety net; (c) financial policies and regulation for resilience and sustainability; (d) implementation of regulatory reforms and cross-border payment services; and (e) institutional policy coherence and governance reform.

* A/75/150.

I. Introduction

1. In its resolution 74/202, the General Assembly recognized the efforts undertaken at the national, regional and international levels since the 2008 world financial and economic crisis to address systemic risks, but also recognized that more needed to be done in several areas, including: managing the consequences of capital flow volatility; tackling rising indebtedness and fiscal strains in many countries; reforming and strengthening the international financial system; and continuing and enhancing the coordination of financial and economic policies at the international level. The coronavirus disease (COVID-19) pandemic, and the social and economic crisis that it has triggered, has amplified underlying risks in the international financial system. Many countries, particularly developing countries, are experiencing heightened capital flow volatility and reduced liquidity, along with falling export earnings and reduced fiscal revenues. For some countries, these pressures are exacerbating already weak debt sustainability and other existing vulnerabilities.

2. The international community has taken steps to respond to the crisis through increased global liquidity and a debt moratorium for the poorest countries. Nonetheless, the scale and possibly prolonged duration of the current crisis call for additional efforts to mitigate the impacts of the pandemic on economies and people and to ensure a more inclusive and sustainable recovery.

3. The national and international responses to the COVID-19 crisis will determine whether the world can overcome this setback in the implementation of the 2030 Agenda for Sustainable Development and build back better. International cooperation will be necessary, including in strengthening the international financial safety net; enhancing financial sector policies and regulation for sustainable development; improving cross-border payment services; and continuing to promote institutional policy coherence and governance reform.

II. Global economic context, financial markets and capital flows

4. The international health crisis caused by COVID-19 has rapidly developed into a severe global economic crisis. Creative and decisive actions by central banks in major economies averted a fully fledged global financial crisis during the market turmoil in March. Despite the recovery of financial markets since April 2020, vulnerabilities persist and many developing countries continue to experience liquidity shortages.

A. Global economy

5. Early indicators of economic activity suggest that the downside scenario of a global economic contraction of about 5 per cent in 2020, as outlined in the midyear update to *World Economic Situation and Prospects 2020* (E/2020/58), is increasingly likely. The prospects for 2021 are even more uncertain, with the midyear forecast ranging from global growth of 4.1 per cent in the baseline scenario to 0.5 per cent in the downside scenario. Some developing countries are expected to see large drops in GDP, especially those that depend on commodity exports and on tourism, and those for which remittances are an important source of income. Small island developing States are among the most vulnerable developing countries.

6. The global economic downturn has also had a dramatic impact on labour markets worldwide. As at June 2020, 93 per cent of the world's workers were living in countries with some type of workplace closure measures in place. The International Labour Organization estimates a decline of 14 per cent in hours worked globally in

the second quarter of 2020 (compared with the last quarter of 2019).[1] Women and young people face a higher risk of losing their jobs, as disproportionally large numbers of them work in economic sectors that have been hit particularly hard by the crisis. In addition, women have been affected by the increase in unpaid care work caused by school and childcare closures and the shift of economic activity into the domestic sphere.[2]

7. Negative growth in GDP per capita and massive losses of employment will exacerbate global poverty, especially in developing countries with limited social protection. According to recent estimates, between 71 million and 100 million people might be pushed into extreme poverty in 2020, wiping out any progress made since 2017.[3]

B. Financial market volatility and debt risks

8. When the scale of the COVID-19 shock became more broadly recognized in March 2020, global financial markets collapsed, with valuations plunging across asset classes and volatility at levels not seen since the onset of the 2008 financial crisis.

9. Swift and decisive action by central banks in major economies averted a fully fledged global financial crisis by putting a floor on falling asset prices and injecting much-needed liquidity. Since April, financial markets have rebounded. By June, equity markets in economies with systemically important financial sectors had recovered an average of about 80 per cent of their mid-January valuations, and the initial widening of spreads in credit markets had retracted by about 70 per cent.[4]

10. Financial vulnerabilities had been building since before the pandemic in both developed and developing countries. While the banking sector in most countries was less vulnerable than during the 2008 financial crisis, as a result, in part, of strengthened regulation, other vulnerabilities have intensified due to increased leverage across the financial system. The low global interest rate environment increased risk-taking by investors, driving up investments in high-yield bonds. In 2019, corporate and household debt relative to GDP surpassed pre-2008 levels. At the same time, the average credit quality of debt fell. The volume of leveraged loans (loans to higher risk corporate borrowers, most of which are then packaged into collateralized loan obligations) doubled in the period since the crisis, to reach $1.2 trillion in 2019.

11. In the first five months of 2020, corporate bond defaults at a global level reached numbers not seen since 2009.[5] While the plunge in valuations across asset classes during March 2020 reflected a repricing of underlying risks, due to both changing fundamentals and fear and uncertainty, it was further fuelled by an unwinding of positions to cover losses and repay debt, which in turn increased pressure across markets.

12. Risk may also have been transferred from the private to the public sector, as central banks have purchased an increased amount of private sector bonds and, in the case of the Federal Reserve System of the United States of America, bank loans to

[1] International Labour Organization, "ILO monitor: COVID-19 and the world of work. Fifth edition: updated estimates and analysis", 30 June 2020.
[2] United Nations, "Policy brief: the world of work and COVID-19", 19 June 2020.
[3] World Bank, "Projected poverty impacts of COVID-19 (coronavirus)", 8 June 2020.
[4] Ibid.
[5] Ibid.

private companies.[6] As a result, the balance sheets of developed economy central banks have increased at more than double the rate seen during 2008–2009.[7]

13. The crisis has also put stress on the debt sustainability of many developing countries, as public spending needs have risen while revenues have been collapsing. This has exacerbated existing sovereign debt risks. Prior to the outbreak of the pandemic, almost half of all the least developed and other low-income countries were already at high risk of, or in, debt distress, and that proportion is increasing owing to the crisis. Many middle-income countries are also experiencing increased pressure on their debt sustainability. For example, six middle-income small island developing States have especially high public debt and debt service burdens, at over 40 per cent of revenue on average.

C. Capital flows

14. The onset of the COVID-19 pandemic triggered record capital outflows from developing countries in the first quarter of 2020. Non-resident portfolio outflows from emerging market countries were almost $100 billion between late January and the end of March, with credit spreads on emerging market sovereign bonds widening to more than 600 basis points and emerging market exchange rates plummeting. Capital outflows due to the pandemic built on already negative trends. At the end of 2019, net capital flows to developing countries were estimated to have returned to negative territory, owing primarily to outflows from East Asia.[8]

15. Since April, international financial markets have stabilized somewhat, and several countries' exchange rates have experienced recoveries, owing in part to a stabilization of oil prices. Middle-income countries attracted non-resident portfolio inflows of some $55 billion in the second quarter, driven by debt issuance by a few countries. In June alone, total inflows reached $32 billion, with debt issuance of $23.5 billion and equity inflows of $9.5 billion.[9] Yet, despite this recovery, many developing countries continue to experience severe liquidity shortages.

16. Foreign direct investment (FDI), while generally more stable and long-term-oriented than portfolio flows, is expected to contract by up to 40 per cent in 2020 – a sharper drop than during the 2008 financial crisis.[10] After reaching $1.54 trillion in 2019, and following lacklustre growth over the past decade, this would see FDI fall below $1 trillion for the first time since 2005. The expected impacts differ by country group: developing countries, in particular, are expected to experience sharper declines in inflows, owing to the bigger role of investment in global value chain-intensive and extractive industries, which have been severely hit. Developing countries also have less fiscal space than developed economies to implement economic support measures.

17. In 2021, financial distress, liquidity constraints and an uncertain economic outlook are expected to continue to weigh on investment plans, with FDI expected to decrease by another 5–10 per cent. Longer-term trends, such as the trends towards shorter and more diversified global value chains, the increasing role of the digital economy and the greater concentration of value added, will affect FDI flows going forward. Investment promotion strategies will need to be adapted to these new and

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[6] Central banks in some developing countries have also employed quantitative easing measures for the first time.

[7] International Monetary Fund (IMF), "Global financial stability update", June 2020.

[8] IMF, *World Economic Outlook: Global Manufacturing Downturn, Rising Trade Barriers* (Washington, D.C., October 2019), table A13. Aggregates have been recalculated on the basis of the United Nations working definition of the term "developing country".

[9] Institute of International Finance, Capital Flows Tracker, data for May, June and July 2020.

[10] *World Investment Report 2020* (United Nations publication, Sales No. E.20.II.D.23).

emerging challenges and opportunities, including by aligning FDI with sustainable development and fostering increased investment in the Sustainable Development Goals in developing countries.

Capital flow management policies

18. While long-term investment can boost growth and support sustainable development, volatile short-term international capital flows can pose significant challenges for developing economies, with a potential impact on asset prices, exchange rates, debt sustainability and financial stability. As Member States recognized in the Addis Ababa Action Agenda, when dealing with risks from large and volatile capital flows, necessary macroeconomic policy adjustment could be supported by macroprudential and, as appropriate, capital flow management measures.

19. A number of countries have taken targeted measures to address capital flow volatility caused by the COVID-19 crisis. Several, especially larger, emerging economies, have relaxed existing limits on capital inflows. Some countries have reduced foreign-currency reserve requirements or suspended taxes on financial institutions' foreign-currency liabilities. Some smaller countries have put in place restrictions on capital outflows and tightened restrictions on international payments and transactions and on the purchase of foreign currency for transfers abroad.[11]

20. Capital account management measures have to be put in place carefully so as not to deter long-term investment in sustainable development. Building capital management frameworks into integrated national financing frameworks would strengthen the coherence between capital account management and macroprudential policies.[12] The International Monetary Fund (IMF) has put forward the concept of an integrated policy framework that can be a part of a broader integrated national financing framework. The integrated policy framework draws on a range of alternatives to formulate the best policy set, including monetary, exchange rate, macroprudential and capital flow management policies, to meet different countries' needs.

21. There is also scope to increase cooperation and explore avenues for multilateral support for capital account management, including through guidance and technical assistance. It could be helpful to develop a better understanding of how source countries of capital flows can meet domestic objectives while avoiding large international spillovers and volatility.

D. Workers' remittances

22. Workers' remittances can strengthen the balance of payments of receiving countries and provide countercyclical support, as migrants tend to send more money to their families when their home country suffers an economic downturn. However, owing to the synchronized character of the COVID-19 crisis, remittances are expected to decline at the same time as international capital flows wane, just as households in recipient countries face greater need. Global remittances to low-income and middle-income countries are expected to fall by about 20 per cent in 2020 (after reaching a

[11] See Organization for Economic Cooperation and Development (OECD), "COVID-19 and global capital flows: OECD report to G20 International Financial Architecture Working Group", June 2020; and IMF, "Policy responses to COVID-19".

[12] See *Financing for Sustainable Development Report 2019* (United Nations publication, Sales No. E.19.I.7).

record high of $554 billion in 2019), owing to a decline in migrant workers' employment and wages in their host countries.[13]

23. At the same time, the cost of transferring remittances remains high in many corridors. The global average cost of sending $200 remained high, at 6.7 per cent, in the second quarter of 2020, only slightly lower than in the previous year.[14] The high cost in part reflects the loss of correspondent banking relationships in some remittance corridors, as discussed below.

III. International response to the crisis and financial safety net

24. The international community has taken steps to respond to the COVID-19 crisis, although the scale and possibly prolonged duration of the challenge call for additional joint efforts to overcome the crisis and ensure a more sustainable recovery.

A. Debt suspension and relief

25. To ease the debt burden of some vulnerable countries, the Group of 20 (G20) debt service suspension initiative on official bilateral debt has been offered to 73 low-income developing countries, including all of the least developed countries and 13 small island developing States, that are eligible for support from the International Development Association of the World Bank. To provide liquidity for additional countries, G20 called upon private sector creditors to participate on comparable terms and upon multilateral development banks to explore options to grant suspension of debt service payments. In addition, IMF is providing debt service relief to 27 of its poorest members, through its Catastrophe Containment and Relief Trust, for an initial phase of six months. It is currently working to raise additional funds for the Trust in order to be able to extend the debt service relief period to two years.

26. While the G20 debt service suspension initiative will free up resources of the participating countries in the short term to address COVID-19-related financing needs, it does not address long-term debt vulnerabilities. Moreover, as the suspension applies only to official bilateral debt, it covers only about one third of the external debt servicing obligations of eligible countries through the end of 2020.

27. The debt service suspension initiative should help to support countries' debt sustainability by providing needed liquidity. Nonetheless, as at July 2020, just over 55 per cent of eligible countries had requested to participate in the initiative. Credit rating agencies have put some eligible countries on negative ratings watch, owing, in part, to the possibility of private creditors joining the initiative and triggering cross defaults. As a result, some debtor countries, especially those with a high proportion of debt owed to private creditors (and thus with a lower percentage eligible to be included in the moratorium), have chosen not to participate. In response, the Institute of International Finance has prepared a draft waiver for cross default clauses in commercial debt contracts, but further discussions with credit rating agencies are warranted.

28. By limiting the initiative to the poorest countries, the initiative also excludes liquidity-constrained middle-income countries, some of which are also at high risk of debt distress or already in debt distress, as noted above.

[13] World Bank, "World Bank predicts sharpest decline of remittances in recent history", press release, 22 April 2020.

[14] World Bank, "Remittance prices worldwide", Issue 34, June 2020.

29. To address sovereign debt distress from a more comprehensive and long-term perspective, a three-pronged approach is proposed in "Debt and COVID-19: a global response in solidarity": (a) a standstill on all debt service for all developing countries that request it; (b) additional debt relief for highly indebted developing countries to avoid defaults and create space for Sustainable Development Goal investments; and (c) progress in the international financial architecture, through fairer and more effective mechanisms for debt crisis resolution, as well as more responsible borrowing and lending.[15] This is in line with the call in the Addis Ababa Action Agenda for debt restructurings to be fair, orderly, timely and efficient, and to create fiscal space for countries to invest in the Sustainable Development Goals.

B. International financial safety net

30. In the Addis Ababa Action Agenda, Member States also recognized the importance of strengthening the permanent international financial safety net, with a strong and quota-based IMF at its centre.

IMF at the centre of the international financial safety net

31. In addition to the debt service relief that it is providing through the Catastrophe Containment and Relief Trust, IMF is responding to emergency funding requests from over 100 countries, through its emergency financing facilities, the Rapid Credit Facility and the Rapid Financing Instrument. The Rapid Credit Facility is a concessional lending instrument for low-income countries that is part of the Poverty Reduction and Growth Trust. IMF is currently working to triple the size of the Trust.[16] The Rapid Financing Instrument is available to all member countries facing an urgent balance-of-payments need, without the need to have a fully fledged programme in place.

32. In April 2020, IMF established a new Short-term Liquidity Line to provide rapid access to liquidity for short-term moderate balance-of-payments support for member countries with very strong policies and fundamentals. Overall demand for the Liquidity Line is estimated to reach up to $55 billion, but no qualifying country had officially requested access to it as at the end of June 2020.

33. Before the outbreak of COVID-19, IMF members endorsed a package on IMF resources and governance reform that maintains the Fund's current overall lending capacity of some $1 trillion.[17] Almost half of this capacity consists of permanent IMF quota resources (beyond providing resource contributions, quotas also serve to determine member countries' voting power, access to financing, and special drawing rights allocations). The remainder of the lending capacity consists of borrowed resources that the Fund may draw upon from member countries in case of need, under the New Arrangements to Borrow and bilateral borrowing agreements.

34. At the end of June 2020, IMF was making about $250 billion, or one quarter of its lending capacity, available to member countries for COVID-19-related financial assistance and debt service relief. Needs are expected to surpass this amount –in April, IMF estimated that the financing needs of developing countries would reach approximately $2.5 trillion – and there may be a need to activate agreed New Arrangements to Borrow and a new round of bilateral borrowing (under bilateral borrowing agreements).

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[15] United Nations, "Debt and COVID-19: a global response in solidarity", 17 April 2020.

[16] For an updated overview of the IMF response to COVID-19, see IMF, "COVID-19 financial assistance and debt service relief".

[17] IMF, "IMF membership endorses package on IMF resources and governance reform", 18 October 2019.

A role for special drawing rights?

35. Beyond its lending capacity, IMF issues special drawing rights to supplement member countries' official reserves. A new issuance of special drawing rights in a crisis context is not without precedent: in 2009, during the global financial crisis, IMF issued 183 billion in special drawing rights to support developing countries, bringing the total cumulative allocations to about 204 billion in special drawing rights (equivalent to about $280 billion in 2020).

36. A range of proposals on using special drawing rights have been put forward, with varying degrees of political support: from a reallocation of existing special drawing rights to more expansive uses that would require institutional changes.

37. In one proposal, IMF member countries could reallocate existing special drawing rights from countries with sufficient international reserves to those countries most in need. For example, countries that do not use their allocations could place them in a trust fund at IMF, which would make them available to countries upon request. Such a trust could be modelled on the IMF Poverty Reduction and Growth Trust or the Catastrophe Containment and Relief Trust, but not limited to low-income countries. However, even a reallocation of $150 billion from high-income to low-income and middle-income countries would likely be insufficient for countries in need. Such a mechanism would require a vote in favour by the Executive Board with the support of 85 per cent of the voting power of the IMF membership.

38. As a second option, a new issuance of special drawing rights could be implemented, which would also require the support of 85 per cent of the voting power of the IMF membership. Without a reallocation, however, these new funds would not necessarily reach the countries most in need, as high-income countries would receive almost two thirds of the total, in line with their IMF quotas. Even so, an issuance of $1 trillion would provide low-income and middle-income countries with about $330 billion of additional international reserves. A smaller issuance of $600 billion may be more feasible, as it would not require parliamentary approval by some large member countries. A new issuance would also require a vote in favour by the Executive Board but not a change to the IMF Articles of Agreement, as long as it was established that there was a "global need to supplement reserves" (art. XVIII, sect. 1 (b), Articles of Agreement).

39. A third option would be the issuance of new special drawing rights, together with a mechanism for their subsequent reallocation to the countries most in need. If such a mechanism or trust fund were to be developed as part of a first step to reallocate existing special drawing rights, it would be ready for use under this scenario. The combination of a new issuance with a reallocation would enhance the liquidity impact of the issuance without much additional cost for the countries that do not use their allocations. Alternatively, wealthier countries could lend their unused special drawing rights back to IMF to increase its lending capacity.

40. Other proposals include the use of special drawing rights for asset purchase programmes or debt buyback funds, for example, to support COVID-19-related expenses or climate investments. Trusts similar to the Poverty Reduction and Growth Trust could be set up at the World Bank and the regional development banks (which are already prescribed holders of special drawing rights).

41. The more radical proposals include increasing the use of special drawing rights as a global currency or as an investment asset by actors beyond central banks, however, this would require institutional changes, which lack sufficient political support.

Regional financial safety nets

42. Regional financing arrangements form an important additional layer of the global financial safety net, by providing regional reserve pooling arrangements, swap lines, lending facilities and technical support. During the current crisis, the Arab Monetary Fund, the Chiang Mai Initiative Multilateralization, the Eurasian Fund for Stabilization and Development, the European Stability Mechanism and the Latin American Reserve Fund have intensified their cooperation with IMF to support their members countries on the ground.

43. In mid-May 2020, the European Stability Mechanism made Pandemic Crisis Support available to its member States in the euro area, up to an amount equivalent to 2 per cent of the members' GDP as at the end of 2019. Also in May, the Latin American Reserve Fund approved a debt programme to increase its lending capacity by 60 per cent, to $6.8 billion. In June, the Arab Monetary Fund approved and disbursed $309 million in financial support to member countries, and an amendment to the Chiang Mai Initiative Multilateralization came into effect that could strengthen its responsiveness to the crisis, including by allowing more flexibility for co-financing arrangements and strengthening the coordination mechanism with IMF.

44. Going forward, cooperation among regional financing arrangements and between regional financing arrangements and IMF can be strengthened further, including through the annual high-level dialogues and joint research seminars held by the regional financing arrangements, and through the enhanced exchange of information and coordination of assistance to member countries, as well as the provision of co-financing arrangements, where appropriate and feasible.

Bilateral swap lines

45. The extension of bilateral swap lines has also supported financial markets and helped to ease international liquidity pressures. Since the beginning of the COVID-19 crisis, the United States Federal Reserve System has expanded the set of countries that are offered swap lines to 14. Between March and May, other central banks drew $449 billion from the Federal Reserve swap lines – less than the peak of $583 billion at the height of the 2008 financial crisis. However, the vast majority of developing countries do not have access to foreign currencies under such arrangements.

C. Multilateral and regional development banks

46. Multilateral and other international development banks are well-placed to support member countries during times of crisis. As a group, these banks entered into 2020 with strengthened funding positions. The International Development Association of the World Bank was replenished with $82 billion for the fiscal years 2021–2023, $7 billion more than the previous replenishment. Shareholders of the African Development Bank approved a $115 billion capital increase in 2019, the largest since its establishment in 1964. The African Development Fund, the concessional fund of African Development Bank, was replenished with $7.6 billion for the period 2020–2022, an increase of 32 per cent from the previous cycle.

47. The World Bank has announced that it will provide up to $160 billion in financing until mid-2021 to combat the COVID-19 crisis, including over $50 billion in resources from the International Development Association on grant or highly concessional terms. In addition to ongoing support for health care, this financing will be focused on social protection, poverty alleviation and policy-based financing. The International Finance Corporation is allocating $8 billion to help micro-, small and medium-sized enterprises, and the Multilateral Investment Guarantee Agency has

launched a $6.5 billion facility to support private sector investors and lenders in tackling the pandemic.

48. Regionally, the European Investment Bank has committed up to €200 billion, the Asian Development Bank $20 billion, the African Development Bank $10 billion, the Inter-American Development Bank $12 billion and the Islamic Development Bank $2.3 billion. The Asian Infrastructure Investment Bank has made available $10 billion under its COVID-19 crisis recovery facility. The New Development Bank announced that it has the financial capacity to provide a total of $10 billion in crisis-related assistance.

49. Despite significant commitments by multilateral and regional development banks, recent estimates suggest that many of them still have room to increase their lending capacity, including by reviewing and reforming statutory lending limits where appropriate.[18] There may also be calls for new capital increases to strengthen lending capacity.

IV. Financial policies and regulation for resilience and sustainability

50. Beyond the immediate crisis response, the pandemic offers an opportunity for countries to build back better, including by incorporating long-term disaster and other non-economic risks into financial policy and regulatory frameworks.

51. An increasing number of central banks and financial regulators have acknowledged the need to respond to non-economic risks – including the effects of climate change – as a repricing of assets may expose insurers and banks to large losses with potential systemic implications for financial stability. However, decision makers need reliable and transparent information about such risks, and their potential impacts on earnings.

52. In the area of climate risks, the recommendations of the Task Force on Climate-related Financial Disclosures include the disclosure of material short-, medium- and long-term risks for an organization's businesses, strategy, and financial planning.[19] However, the largely voluntary nature of sustainability reporting allows companies to decide which indicators they report on, so they can choose to report only on positive results and avoid communicating negative impacts. Despite the progress made, in a survey it conducted in 2019, the Task Force found that the majority of companies do not disclose sufficiently clear information on the potential financial impact of climate-related issues or on the resilience of their strategies.

53. There are thus increased calls to make sustainability reporting mandatory in order to create a level playing field for all and to strengthen the resilience of the economy and financial markets. Such mandatory reporting requirements for large corporations should include a common set of social and environmental metrics to ensure that reporting is meaningful and comparable between companies.

54. In 2019, the Network for Greening the Financial System – an association of 55 central banks and supervisors, including those from almost all the G20 countries – published a set of guidelines that urges peers to price climate change risk when regulating financial companies. The guidelines contain, for example, a recommendation to include climate risk in stress tests for the banking sector or, at a minimum, to

[18] Chris Humphrey, "All hands on deck: how to scale up multilateral financing to face the COVID-19 crisis", Overseas Development Institute, April 2020.

[19] Task Force on Climate-related Financial Disclosures, "Final report: recommendations of the Task Force on Climate-related Financial Disclosures", June 2017.

lengthen the time frame of existing stress tests to include long-term risks.[20] Similarly, IMF is working on incorporating climate risk in macrofinancial stress testing.[21]

55. Financial sector regulations can also support investors who are looking for sustainable investment options by establishing minimum standards for investment products to be marketed as sustainable. For example, the European Union sustainable finance taxonomy, adopted by the European Parliament in June 2020, provides clear criteria to investors on what constitutes a sustainable activity. Furthermore, regulators could require investment advisers to ask their clients about their sustainability preferences along with other information that they already request.

56. During the COVID-19 crisis, government bailout programmes could be made contingent on stricter reporting requirements on socioeconomic and environmental issues. Policymakers could also support longer-term thinking in capital markets, which would help to better account for non-economic risks, by encouraging rating agencies and other market actors to extend the time-horizon of their credit assessments and to develop long-term sustainability-oriented market indices.

57. On monetary policy, the mandates of central banks are generally focused either solely on price stability or on price stability and other socioeconomic factors, such as employment. For many central banks, therefore, the primary question with regard to non-economic risks is the extent to which they will ultimately impact these objectives.

58. There is no consensus on the role of central banks' own portfolios in supporting green investment. For instance, the United States Federal Reserve System and the Bank of Japan consider this to fall outside their mandates, while the Bank of England and the European Central Bank have indicated strong interest in such policies. In 2019, the Bank for International Settlements launched a green bond fund, as an option for central banks to include environmental sustainability objectives in their reserve management.[22]

59. Central banks that are able could take a more active role, by accounting for how monetary policy decisions influence non-economic risks. For example, a second recommendation by the Network for Greening the Financial System is for central banks to consider sustainability goals in their own portfolio management. Calls for green quantitative easing, including as part of central banks' COVID-19 response, go in this direction, as do other proposals, such as climate-oriented collateral frameworks, credit allocation policies and direct financial incentives.

V. Implementation of regulatory reforms and cross-border payment services

60. The COVID-19 crisis, as the first big test to the financial system since the 2008 financial crisis, has shown that the financial system, in particular the banking system, is more stable than it was in 2008. Nonetheless, it has also exposed vulnerabilities, including in non-bank financial institutions.

61. Prior to the outbreak of the pandemic, there was increased focus on the unintended consequences of regulation on sustainable development. One such area of

[20] Network for Greening the Financial System, "First comprehensive report: a call for action – climate change as a source of financial risk", April 2019.

[21] Tobias Adrian, James Morsink and Liliana Schumacher, "Stress testing at the IMF", Monetary and Capital Markets Department, departmental paper No. 20/04 (International Monetary Fund, Washington D.C., 2020).

[22] Bank for International Settlements, "BIS launches green bond fund for central banks", press release, 26 September 2019.

concern was correspondent banking, with implications for cross-border flows and payments, including remittances.

A. Regulation of banking and non-banking financial institutions

62. As part of the policy response to the COVID-19 crisis, financial supervisory authorities in many countries have taken a range of measures to support liquidity provision and maintain business continuity of banks and payment systems. International standard-setting bodies have issued guidance to support national authorities, encouraging them to: make use of the flexibility within global standards; review and adjust timelines for the implementation of agreed standards; and enhance transparency and consumer protection.[23] IMF and World Bank staff also provided a joint set of recommendations for supervisory authorities that encourage flexibility while upholding internationally agreed minimum regulatory standards and supervisory principles in order to minimize the build-up of new medium-term financial stability risks.[24]

63. The main financial regulatory reforms agreed by G20 in the wake of the 2008 financial crisis are now in place, although progress in their implementation has been uneven. Going forward, additional work will be needed to ensure that reforms keep pace with an evolving financial system and new and emerging vulnerabilities.[25]

64. Large banks are better capitalized, less leveraged and hold more liquidity than prior to the 2008 financial crisis. Nonetheless, a slower-than-expected recovery and an increase in debt defaults and bankruptcies will test financial institutions' capacity to absorb losses. To preserve bank capital in anticipation of such losses, central banks around the world have restricted share buybacks and dividend distributions. In July 2020, G20 countries included this approach as one option for safeguarding the banking sector's loss absorbency and lending capacity.[26] While a number of central banks have postponed regular stress testing exercises, many have conducted or are implementing vulnerability analyses to assess banks' preparedness to address the risks to capital and liquidity arising from the current crisis.[27]

65. Some progress has also been made on the regulation of non-bank financial institutions,[28] which currently bear a greater share of financial risk and can be connectors that spread risk and volatility to other parts of the financial system. Although regulation gaps remain, in part reflecting the dynamic nature of the sector, members of the Financial Stability Board have adopted an internationally agreed monitoring framework. Implementation of money market fund standards is advanced in the countries hosting the largest markets for these funds. Implementation of measures to better align the incentives of institutions issuing asset-backed securities

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[23] IMF and World Bank, "COVID-19: the regulatory and supervisory implications for the banking sector – a joint IMF-World Bank staff position note", 21 May 2020; and Financial Stability Board, "COVID-19 pandemic: financial stability implications and policy measures taken", 15 April 2020.

[24] IMF and World Bank, "COVID-19: the regulatory and supervisory implications for the banking sector".

[25] Financial Stability Board, "Implementation and effects of the G20 financial regulatory reforms: fifth annual report", 16 October 2019.

[26] Group of 20 (G20), communiqué of the G20 Finance Ministers and Central Bank Governors Meeting, 18 July 2020.

[27] See, for example, Institute of International Finance, "Prudential regulatory measures in response to COVID-19 (as of July 10, 2020)".

[28] Non-bank financial institutions include structured finance vehicles, investment funds, money market funds, hedge funds, broker-dealers, trust companies and other non-bank and non-insurance lenders.

with the risks embedded in the securities has also made good progress, but new products with similar risk profiles are continually developed, and application of the risk-retention rules to different product categories is not uniform.

66. A number of countries have included non-bank financial institutions in their recent support measures for the financial sector, including access to loan guarantees and the ability to engage in repo activities to receive foreign currency.[29]

B. Correspondent banking

67. Correspondent banking relationships facilitate the bulk of cross-border payments that underpin global trade, finance and remittances. They are arrangements under which a bank (usually a large international bank) in the receiving country (the correspondent) holds deposits owned by other banks from the sending country (the respondents). The correspondent bank provides the respondents with payment and other services in the local market. Respondents open accounts in the correspondent's books and exchange messages to settle obligations by crediting and debiting those accounts.[30]

68. Despite a large increase in cross-border payments over the last decade – driven by growing international trade, expanding cross-border e-commerce activity and rising international travel and migration – the number of correspondent banking relationships fell by 20 per cent between 2011 and 2018.[31] Over the same period, the number of active payment corridors between countries decreased by 10 per cent, from 10,800 to 9,800.[32] These declines have been uneven between regions, with Latin America and the Caribbean and Oceania losing the largest shares of both relationships and corridors.[33]

69. The decrease in correspondent banking relationships can hamper a country's access to the global financial system. While a complete loss of access is rare, the reduction of corridors may lengthen payment chains as transactions are rerouted via third countries. Longer payment chains tend to increase the cost of a transaction, as well as the time that it takes to complete. A decline in the number of correspondent banks may also reduce competitive pressure, thus keeping transaction costs from falling.

70. The loss in active correspondents can be linked to high remittance costs in some regions. In general, regions with the fewest active correspondents, especially in Africa, face higher remittance costs.[34] While remittance costs have been declining globally, they fell to a lesser extent in countries that lost more active correspondents. And the few countries that witnessed an increase in remittance costs have all seen a decline in correspondents.

71. It is likely that several factors contributed to the retreat in correspondent banking, including the high cost of complying with anti-money-laundering and combating the financing of terrorism regulations, which are important for curtailing illicit financial flows). According to a recent study, countries perceived to be at a higher risk for illicit financing or with weaker governance indicators were more likely

[29] See, for example, IMF, "Policy responses to COVID-19".
[30] See Committee on Payments and Market Infrastructures, *Correspondent Banking* (Bank for International Settlements, 2016); and Morten Bech and Jenny Hancock, "Innovations in payments", *BIS Quarterly Review*, March 2020, pp. 21–36.
[31] As measured by the flow of SWIFT payment messages.
[32] An active corridor is a country pair that saw at least one transaction in a given period.
[33] Tara Rice, Goetz von Peter and Codruta Boar, "On the global retreat of correspondent banks", *BIS Quarterly Review*, March 2020, pp. 37–52.
[34] Ibid.

to lose active correspondents. On the other hand, increasing economic dynamism and demand for cross-border financial services were supportive of correspondent banking relationships, as evidenced by a positive impact of GDP and trade growth on the number of active correspondents.[35] This trade-off between the perceived risks of not complying with anti-money-laundering and combating the financing of terrorism regulations and macroeconomic performance can cause a severe undersupply of services for the poorest and most vulnerable countries.

72. There are a number of options for strengthening cross-border payment services by reducing the cost of complying with regulatory standards, managing other risks and enhancing transaction efficiency. In particular, technological advances related to financial technology (fintech) present opportunities to reduce costs. The Financial Stability Board is coordinating the development of a road map to enhance cross-border payments, to be presented to G20 in October 2020. Suggested building blocks for the road map can be grouped into five areas: (a) committing to a vision to enhance cross-border payments; (b) coordinating on regulatory, supervisory and oversight frameworks; (c) improving existing payment infrastructure and arrangements; (d) increasing data quality; and (e) exploring the potential role of new payment infrastructure and arrangements.[36] Specifically, a risk-based approach to know-your-customer requirements and strengthened public-private data-sharing arrangements – with appropriate privacy and data protection – could reduce due diligence costs for providers and thus help to lower the costs of remittances transfers.

C. Financial technology and cross-border payments

73. Fintech solutions have been instrumental in reducing the cost of cross-border payments, notably in the case of remittances.[37] Nonetheless, such services, including, for example, mobile money providers, are geared mostly towards reducing inefficiencies at the user-facing front end of cross-border transactions, such as the reception and disbursement of payments. At the back end, most of these services rely on the services of correspondent banks for the messaging, clearing and settlement functions needed to carry out the transactions. Some providers have begun to offer closed-loop solutions, where they operate on the front end in all involved jurisdictions and manage their own back-end operations, either alone or as part of a consortium. However, such models are still relatively small in scale and generally suffer from a lack of interoperability with other providers.

74. The use of distributed ledger technology in the SWIFT payment system is currently being explored with a view to improving the speed, transparency and end-to-end tracking of payments in its global payments innovation initiative. Distributed ledger technology could also reduce the cost of trade finance, although most applications are still at the pilot stage.

75. Distributed ledger technology also underlies most cryptoassets and so-called "stablecoins", both of which have been touted for their potential to enhance the efficiency and speed of international transactions, thus reducing the reliance on traditional correspondent banking relationships. Stablecoins are tied to a basket of other currencies or assets and backed by a reserve fund of liquid assets, in an attempt to lend them greater stability compared with cryptoassets, some of which have been

[35] Ibid.

[36] See Financial Stability Board, "Enhancing cross-border payments: stage 1 report to the G20 – technical background report", 9 April 2020; and Committee on Payments and Market Infrastructures, *Enhancing Cross-Border Payments: Building Blocks of a Global Roadmap – Stage 2 report to the G20* (Bank for International Settlements, July 2020).

[37] World Bank, "Remittance prices worldwide".

known for their large fluctuations in value. This would bring stablecoins much closer to fulfilling the functions of a global currency, warranting increased regulatory scrutiny.

76. As noted in the *Financing for Sustainable Development Report 2020*,[38] cryptoassets could have efficiency benefits, but also have the potential to fundamentally alter the balance of risks and incentives in domestic financial systems, including financial integrity, financial stability and sustainable development risks.

77. The anonymous and decentralized nature of cryptoassets has led to concerns about their use for illicit finance and other fraudulent activities. In October 2018, the Financial Action Task Force updated its standards and recommendations regarding cryptoassets and called upon jurisdictions to include them in anti-money-laundering and combating the financing of terrorism regulations.

78. Regulators and international standard-setting bodies have voiced their concerns about the impact of "global stablecoins", ranging from their potential to facilitate illicit financial flows to their implications for financial stability and the autonomy and effectiveness of monetary policy, especially in smaller developing countries. In April 2020, the Financial Stability Board delivered a report to G20 on regulatory issues in connection with global stablecoins, highlighting vulnerabilities and potential risks and proposing a set of recommendations for national policymakers to advance consistent and effective regulation and supervision, as well as cross-border cooperation and information-sharing.

VI. Other issues related to the financial system

A. Institutional and policy coherence

79. Increasing the coherence and consistency of the international financial and monetary and trading systems has long been a central concern in the financing for development process. The institutions that form these international systems must first fulfil their own missions and respond to inputs from their member countries. However, if they were to adopt a broader vision, it could encourage them to embrace policy measures to enhance coherence with globally agreed goals. For instance, such a broader vision is helping to strengthen coherent action regarding the impact of environmental risks on financial stability.

80. The seventy-fifth anniversary of the United Nations presents an opportunity to consider the Organization's role in positive change, even more so in the context of the current global challenges resulting from the COVID-19 pandemic. The General Assembly and the Economic and Social Council serve as the main forums for forging a global consensus around key economic and social policy norms and targets, most recently in the 2030 Agenda and its Sustainable Development Goals and the Addis Ababa Action Agenda. The discussions, in particular in the Economic and Social Council forum on financing for development follow-up, on the full range of policies that could advance the financing of sustainable development illustrate how the United Nations can contribute to coherence by bringing different institutions, Governments and other stakeholders together through its convening authority.

81. Special high-level meetings, such as the High-level Event on Financing for Development in the Era of COVID-19 and Beyond, which was convened by the Secretary-General on 28 May 2020, can help to generate consensus and facilitate a

[38] *Financing for Sustainable Development Report 2020* (United Nations publication, Sales No. E.20.I.4).

rapid and comprehensive global response in times of crisis. An ambitious follow-up process to the event is expected to deliver tangible financing and development solutions by December 2020, including on: external financial flows and remittances; recovering better for sustainability; global liquidity and financial stability; debt vulnerabilities and the role of private sector creditors; and illicit financial flows.

B. Governance reform at international financial institutions

82. In the Addis Ababa Action Agenda, Member States recommitted to broadening and strengthening the voice and participation of developing countries in international economic decision-making and reiterated their commitment to further governance reform in both IMF and the World Bank.

83. In February 2020, the Board of Governors of IMF concluded the fifteenth general review of quotas with no increase in IMF quotas.[39] For the sixteenth review of quotas, to be concluded no later than 15 December 2023, it requested the Executive Board to revisit the adequacy of quotas and continue the process of IMF governance reform. It stated its expectation that any adjustment in quota shares would result in increases in the quota shares of dynamic economies in line with their relative positions in the world economy, while protecting the voice and representation of the poorest members.

84. In October 2019, the joint World Bank-IMF Development Committee endorsed the proposed International Development Association voting rights review, requesting the Board of Directors of the Association to present an agreed timeline for the review by October 2020.[40] In the endorsed guiding principles, it is recognized that the voting power of the Association's recipient countries should be protected and, if possible, enhanced.[41] The recent capital increase of the African Development Bank (see section III.B) will not change the distribution of voting rights at the bank. In November 2019, the Financial Stability Board agreed on a set of recommendations for enhancing the effectiveness of its six Regional Consultative Groups, expected to encourage greater input from non-member authorities into the work and agenda of the Financial Stability Board.

85. Multilateral development banks are continuing to work on aligning their operations with the Sustainable Development Goals, as requested in the Addis Ababa Action Agenda. In 2019, several multilateral development banks[42] agreed to a common "value for money" framework to optimize their resources. As part of the framework, the participating banks agreed on a common definition of climate finance for joint reporting purposes. They also recognized the importance of reporting on gender equality, and a working group on gender was examining ways to strengthen the harmonization of indicators.[43] These efforts are similar to those currently under

[39] IMF, "IMF Board of Governors approves a resolution on quota reviews", press release, 13 February 2020.

[40] World Bank, "World Bank/IMF Annual Meetings 2019: Development Committee communiqué", press release, 19 October 2020.

[41] World Bank-IMF Development Committee, "IDA voting rights review: report to Governors", 18 September 2019.

[42] The African Development Bank, the Asian Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank Group, including the European Investment Fund, the Inter-American Development Bank (IDB) Group, including IDB Invest and the Multilateral Investment Fund, and the World Bank Group, including the International Finance Corporation and Multilateral Investment Guarantee Agency.

[43] African Development Bank and others, "Multilateral development banks' final report on value for money", 2019.

consideration by the United Nations system, following recommendations by the High-level Task Force on Financing for Gender Equality.

C. Women's leadership in the economy

86. In 2019, women continued to account for about one third of owners of formal sector enterprises worldwide, according to enterprise surveys. However, since the data are updated only in a few countries each year, it is difficult to detect meaningful global trends. There is a more noticeable positive development regarding the participation of women in corporate boards, which increased from 18 per cent in 2018 to 20 per cent in October 2019. Nonetheless, based on current trends, it would take until 2044 to reach gender parity.[44] The International Labour Organization estimates that only 1.4 per cent of all employed women were classified as employers in 2019, compared with 3.4 per cent of men.[45]

VII. Conclusions

87. **The COVID-19 pandemic, and the social and economic crisis that it has triggered, is threatening the achievement of the 2030 Agenda. The international community, and all layers of the international financial safety net, are called upon to support developing countries, by: addressing debt vulnerabilities; ensuring sufficient access to international liquidity; and supporting stable and long-term-oriented financial flows for inclusive growth.**

88. **The G20 debt service suspension initiative is an important step to free up resources of the participating countries in the short term; it should be implemented rapidly, and strong consideration should be given to extending it to the end of 2021. Nonetheless, a broader approach will be needed to address sovereign debt distress from a more comprehensive and long-term perspective.**

89. **The international financial safety net, with IMF at its centre, needs to strengthen its support for developing countries to meet urgent liquidity needs. Beyond increasing the access to emergency financing facilities, which may require additional funding, a new issuance of special drawing rights could provide member countries with additional international reserves at low cost, but would require sufficient political support. In order to enhance the liquidity impact, a new issuance could be combined with a mechanism allowing the reallocation of special drawing rights from countries with sufficient international reserves to those countries most in need.**

90. **To address the challenges of volatile capital flows for macroeconomic and financial stability, national policymakers can incorporate capital management frameworks into integrated national financing frameworks, which would allow countries to better manage inflows, while also strengthening the coherence between capital account management and macroprudential policies.**

91. **The COVID-19 crisis has once again brought to the fore the impact of non-economic risks on economic and financial stability. Mandatory reporting requirements and common standards can help to address these risks, while creating a level playing field for companies. In a further step, central banks and regulatory authorities that are able can also consider including sustainable**

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[44] MSCI, "What if gender parity is out of reach for corporate boards?" (accessed on 6 July 2020).

[45] International Labour Organization, *World Employment and Social Outlook: Trends 2020* (Geneva, 2020).

development considerations in their own policies, in accordance with their mandates.

92. **Increased institutional and policy coherence is needed to strengthen the response of the international community to the current crisis and to ensure a sustainable and inclusive recovery. The seventy-fifth anniversary of the United Nations presents an opportunity to consider the Organization's role in positive change, even more so in the context of the current global challenges resulting from the COVID-19 pandemic.**