CFA Institute
Systemic Risk Council

Systemic Risk Annual Report

2024 ANNUAL REPORT

INSIDE

CFA Institute Systemic Risk Council (SRC or the Council) is a private sector, nonpartisan body of former government officials and financial and legal experts committed to addressing regulatory and structural issues related to global systemic risk, with a particular focus on the United States and Europe. It was formed in 2013 following the Great Financial Crisis to provide a strong, independent voice for reforms that are necessary to protect the public from financial instability. The mission remains- to promote global economic resilience to help ensure a financial system in which we can all have confidence.

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Welcome to the 2024 Annual Report of CFA Institute Systemic Risk Council. This report looks back on the key challenges and issues of the year, and offers some thoughts on the year ahead. Since 2013, this Council has offered an independent, noncommercial voice to assess significant financial and economic disruptions and to make recommendations for building a more robust process for systemic risk oversight in the US, Europe and around the globe. The Council provides an unvarnished assessment of the readiness of global regulatory institutions to deal with evolving systemic vulnerabilities. Our members advocate through comment letters and media commentary on improvements in the detection, monitoring and response to ever-emerging threats to economic stability.

The past two decades have seen an unprecedented number of major financial disruptions, which have stressed the resilience of our global financial systems. The latest episode involved three US regional bank failures, prompting authorities to invoke emergency measures to stem contagion across the broader financial system. Notably, this was the first instance of a social media induced run of a systemic size, aided by fintech apps. We saw the traditional tools of regulators for dealing with market disorder and resilience quickly outpaced.

We entered 2024 with lingering concerns about potential disruptions, as the global economy continued to unwind from unprecedented fiscal and monetary stimulus. Despite heightened recession risks, geopolitical tensions, and shifting political landscapes, the so-called "no landing" scenario has played out. No recession, no inflation spikes, no interest rate hikes, no labor instability, no market sell offs have left the broader economy largely intact.

The resilience of economies and markets through 2024 serves as a reminder of a well-known tenet—market timing and predicting economic disruptions is an elusive business. Developing an effective, early warning system for systemic risks, along with robust mitigation strategies, is no less daunting.

Each year, global regulators work to anticipate and prepare for emerging threats, a challenge that has only intensified with the rapid evolution of cyber and fintech developments. As these risks accelerate, the need for forward-thinking scenario planning and proactive risk management has never been greater.

Thank you for your support. Visit us at www.systemicriskcouncil.org.

. — ***Kurt N. Schacht, JD, CFA, Executive Director***

LETTER FROM SRC CO-CHAIRS

SYSTEMIC RISK AMID GLOBAL LEADERSHIP CHANGES: KEEPING OUR EYE ON THE BALL

The start of President Trump's new administration has sparked renewed debate and raised pressing questions about the future of systemic risk and our readiness to face economic disruption. The variety of risks include many areas we at the SRC have already explored in recent months and years. Yet, with new policy changes, emergent systemic concerns may also arise including global trade disputes, uncertain fiscal policy, and a more rapid decentralization of finance. Similar political shifts around the globe have further intensified the level of uncertainty.

The key question now is whether regulators and central banks need to rethink and accelerate their approach to addressing the economic stability challenges confronting global markets. Systemic risks can intensify quickly and rarely wait on hold for policy leadership to catch up. Our members remain committed to identifying systemic vulnerabilities—both longstanding and emerging—that feature regardless of changes in US leadership. The challenges of recent years remain, and staying prepared is more important than ever.

In our view, particular concerns remain regarding the completion of long-overdue bank regulatory reforms that harken back to the great financial crisis (GFC). While many of the reforms that were implemented post-GFC have improved economic resilience and helped markets weather subsequent economic disruptions, there is no time for complacency. In this context, we hold that it is of great importance to complete the objectives outlined in Basel III reforms which have been pending for more than a decade.

Likewise, there are other lingering systemic risk reforms that need action, such as continued planning for Non-Bank Financial Intermediary (NBFI) risks. We add to this list the urgency for upgrading our cyber threat detection and preparedness, keeping pace with new and emerging developments in AI, and the potentially systemic implications of rapid expansion in cross-border activity across crypto markets. The past year also provided numerous examples of potential systemic implications from extreme weather. We will continue to drill down on the looming dangers to economic stability posed by climate-related disasters.

Finally, we would be remiss if we did not emphasize geopolitical conflict as a most volatile and looming systemic threat. Taking steps to scenario plan, stress test, and build emergency response strategies has never been more important as we witness the ever-present danger from perilous regional conflicts.

We will continue our efforts to engage with government leaders and regulators from around the world as we press on systemic awareness and actions needed to improve systemic risk preparedness, regardless of changing political agendas. As always, we welcome your comments and suggestions on our agenda. The following is our current list of leading systemic risk issues.

TOP 2025 SYSTEMIC RISKS PRIORITIES:

Non-Bank Financial Intermediaries: The growing prominence of NBFIs, combined with limited oversight, poses challenges such as hidden leverage, interconnected risks with traditional banks, and market instability during times of stress. A process for comprehensive and consistent disclosure plus cross border cooperation remains essential.

Cybersecurity Threats: The increasing sophistication and frequency of Artificial Intelligence (AI) and other technologically empowered cyberattacks present crucial risks to financial institutions, infrastructure, and overall market stability.

Geopolitical and Macroeconomic Risks: Persistent inflation, trade wars, high global debt, geopolitical tensions, and the Russia–Ukraine conflict contribute to financial and economic instability, testing resilience across markets.

Climate Change Implications: Climate-related disasters and the implications for broad economic instability are still discounted and as a result, readiness planning is uncoordinated and lacking. We are vulnerable to global environmental disruptions and their potential to amplify systemic risks.

AI Herding and Manipulation: AI's rapid adoption in finance raises new flags about what could happen to market herding, concentration risks, algorithmic market manipulation, and the need for robust global oversight to address potential disruptions.

Basel III End Game: Failure to complete some version of agreed-upon post-GFC reforms for the banking sector, particularly those addressing capital adequacy, quality stress testing, and consistent liquidity and leverage standards is a serious systemic vulnerability.

Cryptocurrency and Digital Finance: The expansion of crypto markets and digital finance, with limited regulatory oversight, creates systemic vulnerabilities and cross-border monitoring challenges.

Commercial Real Estate and Asset Valuation Risks: Even though the predicted Covid shock to commercial real estate has remained muted, elevated asset valuations and vulnerabilities in the commercial real estate sector have not vanished. These could still lead to significant systemic disruptions.

- ***Simon Johnson, SRC Co-Chair and former IMF Chief Economist, Recipient of 2024 Nobel Prize in Economics***
- ***Erkki Liikanen, SRC Co-Chair and Chair of the IFRS Foundation***

2024 IN REVIEW

SRC ACTIVITIES IN 2024

The Council continues to advocate for stronger regulatory measures to address emerging threats to financial stability, including these recent measures:

SRC Urges Fed Action for Oversight of CRTs: The Systemic Risk Council (SRC) remains steadfast in addressing systemic vulnerabilities in the financial system. In the past year, the SRC urged the Federal Reserve to enhance oversight of credit risk transfer (CRT) transactions, which are increasingly used by global banks to offload credit and interest rate risks. The SRC highlighted concerns that CRTs may amplify systemic risks through risk concentration, opaque lending practices, and uncertain performance in market downturns. See comment letter.

Reinstating TAG Program: Additionally, the SRC emphasized the importance of reinstating the Transaction Account Guarantee (TAG) program, which played a critical role during the 2008 financial crisis by safeguarding business deposits. The Council warned that the absence of such protections contributed to recent bank failures, including Silicon Valley Bank and Signature Bank, and called for swift action to restore the TAG program as a vital step toward financial stability.

SRC ROUNDTABLES AND PRESENTATIONS

In 2024, the Systemic Risk Council engaged in discussions and hosted presentations with key thought leaders addressing critical systemic risks and strategies to strengthen global financial stability.

This year's thought-leader discussions included: **Michael J. Hsu**, Acting Comptroller of the Currency at the Office of the Comptroller of the Currency; **Gary Gensler**, Chair of the U.S. Securities and Exchange Commission; **Michael S. Barr**, Vice Chair for Supervision at the Federal Reserve Board of Governors; **Klaas Knot**, President of De Nederlandsche Bank and Chair of the Financial Stability Board; **Martin J. Gruenberg**, Chair of the Federal Deposit Insurance Corporation; **William Nelson**, Chief Economist at the Bank Policy Institute; **Professor Yuriy Gorodnichenko** of the University of California, Berkeley; and **John Berrigan**, Director-General for Financial Stability at the European Commission.

Top Financial System Challenges

Thought leaders identified ongoing risks facing the financial system, including market herding and over concentration, illiquidity of many financial products, and interest rate risks. Emerging challenges such as vulnerabilities in the area of synthetic risk transfers, also known as credit risk transfers (CRTs), were also emphasized. While CRTs help large banks shift credit and interest rate risks to private investors, their potential vulnerabilities where investors use leverage and securitization techniques that could concentrate risks within the financial system, drawing parallels to the financial engineering that occurred during the 2008 Global Financial Crisis (GFC).

Advances in Cybersecurity and AI Technology

Cyber risks remain a top threat, with potential for severe disruptions through stealth attacks that exploit vulnerabilities. Leaders underscored the need for advanced defenses, given the increasingly sophisticated nature of cyberattacks and AI's potential to further accelerate the speed and complexity of such attacks. While AI enhances efficiency in the context of financial markets, it also introduces potential disruptions, such as market herding, increased concentration risks, and challenges in global oversight. Technological disruptions in digital finance and payment platforms, which are assuming banking-like roles without equivalent regulatory oversight, are of particular concern.

Growth of Nonbank Financial Intermediaries

NBFIs, including hedge funds and private equity firms, are playing a larger role in global markets but operate with limited regulatory requirements and oversight. The increasing interconnectedness of these entities with regulated banks and reliance on leverage amplifies the risk of systemic disruption.

The Financial Stability Oversight Council (FSOC), operating in the US markets, has recently increased efforts to mitigate these risks including reforming the process for designating certain NBFIs as systemically important financial institutions (SIFIs). This would subject Nonbank SIFIs to greater regulatory scrutiny, enhanced stress testing, and expanded disclosure requirements. This data collection would undergo advanced modeling to identify systemic trouble spots earlier and help in managing risks in this NBFI sector.

Bank Resolution and Stability Frameworks

Concerns were raised in late 2023 about the untested nature of the resolution frameworks for global systemically important banks (GSIBs). Events like the UBS takeover of Credit Suisse highlighted the political complexities and risks of resolving large institutions during crises. There has been an ongoing reassessment in the US markets on the importance of applying Dodd-Frank resolution frameworks and whether they are still fit-for-purpose. This includes Title II to ensure orderly wind-downs of GSIBs. While mega-regional banks are not classified as GSIBs, they are increasingly viewed as posing significant new challenges to the resolution approach, underscoring the need for vigilant monitoring and capital requirements in this category.

Persistent Geopolitical Conflicts

The Russia–Ukraine war remains a significant source of systemic risk and global market uncertainty as politics and policies change. Key issues include continued strain on EU public finances from both refugee influxes and increased defense spending. Potential disruptions in energy and grain markets due to Black Sea trade route instability, continue to threaten global food security and commodity pricing. Potential risks from more aggressive sanctions on Russia and the handling of frozen assets, could easily destabilize markets and further complicate geopolitical relations.

Digital Finance and Cryptocurrency Regulation

Cryptocurrencies and digital finance platforms continue to expand globally, but their rapid growth presents unique challenges. There will be a new, less aggressive approach to crypto market regulations in the U.S. to encourage innovation and global leadership on digital finance. Yet, issues such as undetected transactions, tax evasion, market manipulation, cross-border fraud and money laundering are still prominent. Any new rules around crypto brokerage and exchange designations can foster innovation but they must also factor in systemic risks and keep pace with rapidly evolving digital products and practices.

European Union Financial Challenges

EU regulators highlighted ongoing efforts to maintain resilience through the implementation of Basel III guidelines, focusing on enhanced capital requirements and robust bank resolution frameworks. The rise of NBFIs in Europe, coupled with ongoing work to align green policies and ESG disclosure standards, is reshaping financial stability priorities. Climate change risks and the impact of artificial intelligence on financial markets remain areas of regulatory concern.

Role of the Federal Reserve's Discount Window

There was emphasis on the stigma associated with borrowing from the Federal Reserve's discount window. Despite its critical role in ensuring liquidity during crises, banks remain reluctant to use it due to perceptions of weakness. Proposed solutions to reduce this stigma include requiring banks to maintain borrowing capacity at the discount window, establishing committed collateralized lines of credit, and enhancing public understanding of its purpose.

Navigating Inflation and Economic Disparities

Persistent inflation, coupled with rising debt levels and elevated asset valuations, remains a pressing concern, particularly in the United States. While financial conditions have improved in 2024, disparities in economic stability continue to create systemic vulnerabilities, including potential market volatility.