



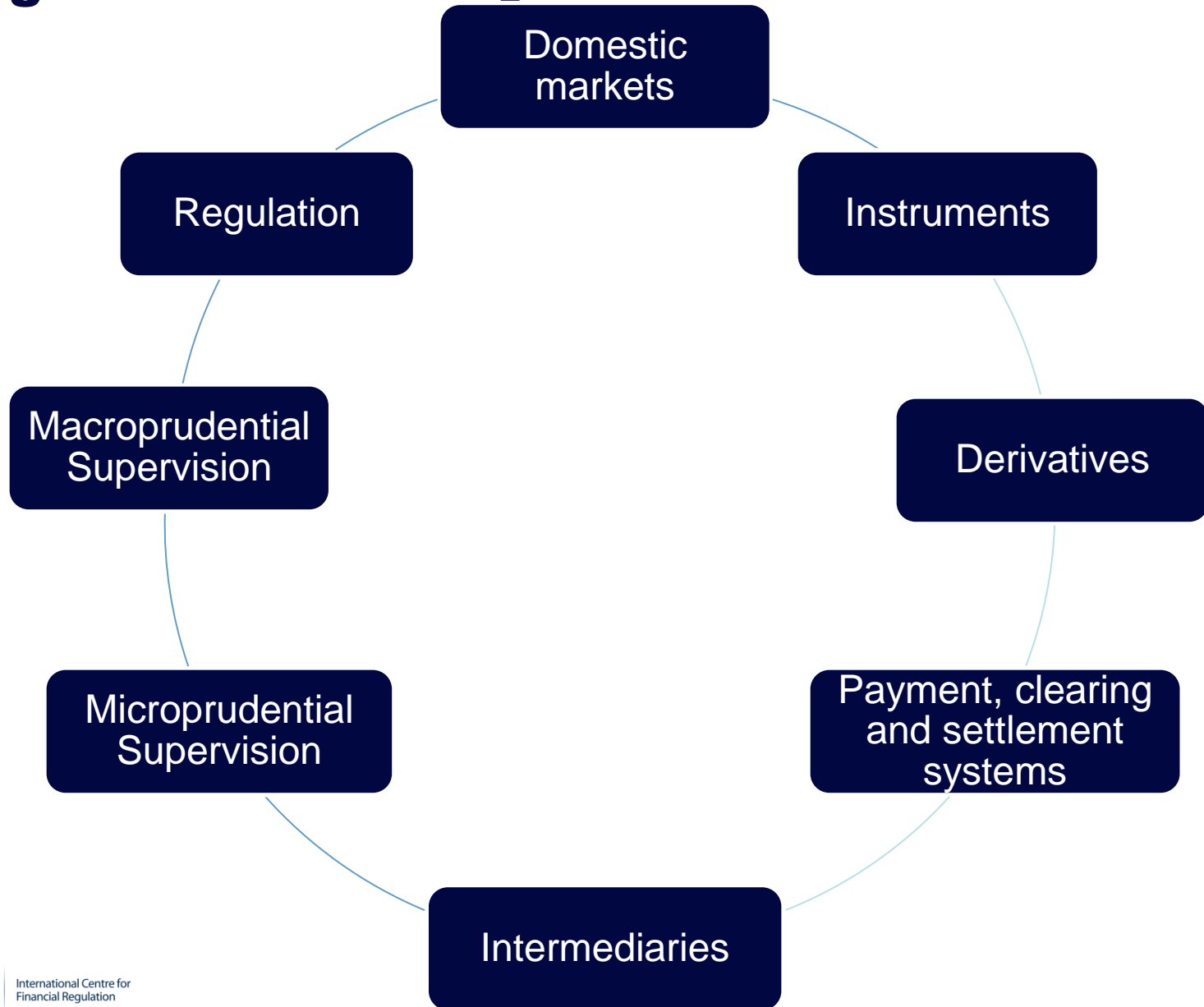
# **THE PROGRAMME FOR FINANCIAL REGULATORY REPAIR (EU, UK and global aspects)**

QATAR - REGULATORY REPAIR SEMINAR  
Misha Patel – Further Supporting Material  
10 February 2010



International Centre for  
Financial Regulation

# The global financial system



# How did we get where we are today?

- Low interest rates
- Excessive financial leverage
- Lack of access to liquidity
- Complexity of financial products
- Poor corporate governance practices
- Lack of effective risk management at large institutions
- Inadequate appreciation/regulation of derivatives risk
- Conflicts of interest at rating agencies
- Market failure to self-correct

# Global governmental crisis management toolkit

## Economic Policy

monetary & fiscal changes (interest rates & quantitative easing) to restore liquidity, encourage lending & spending

## Regulation

Micro and macro prudential regulation, moral hazard, too big to fail, decrease systemic risk

TOOLS

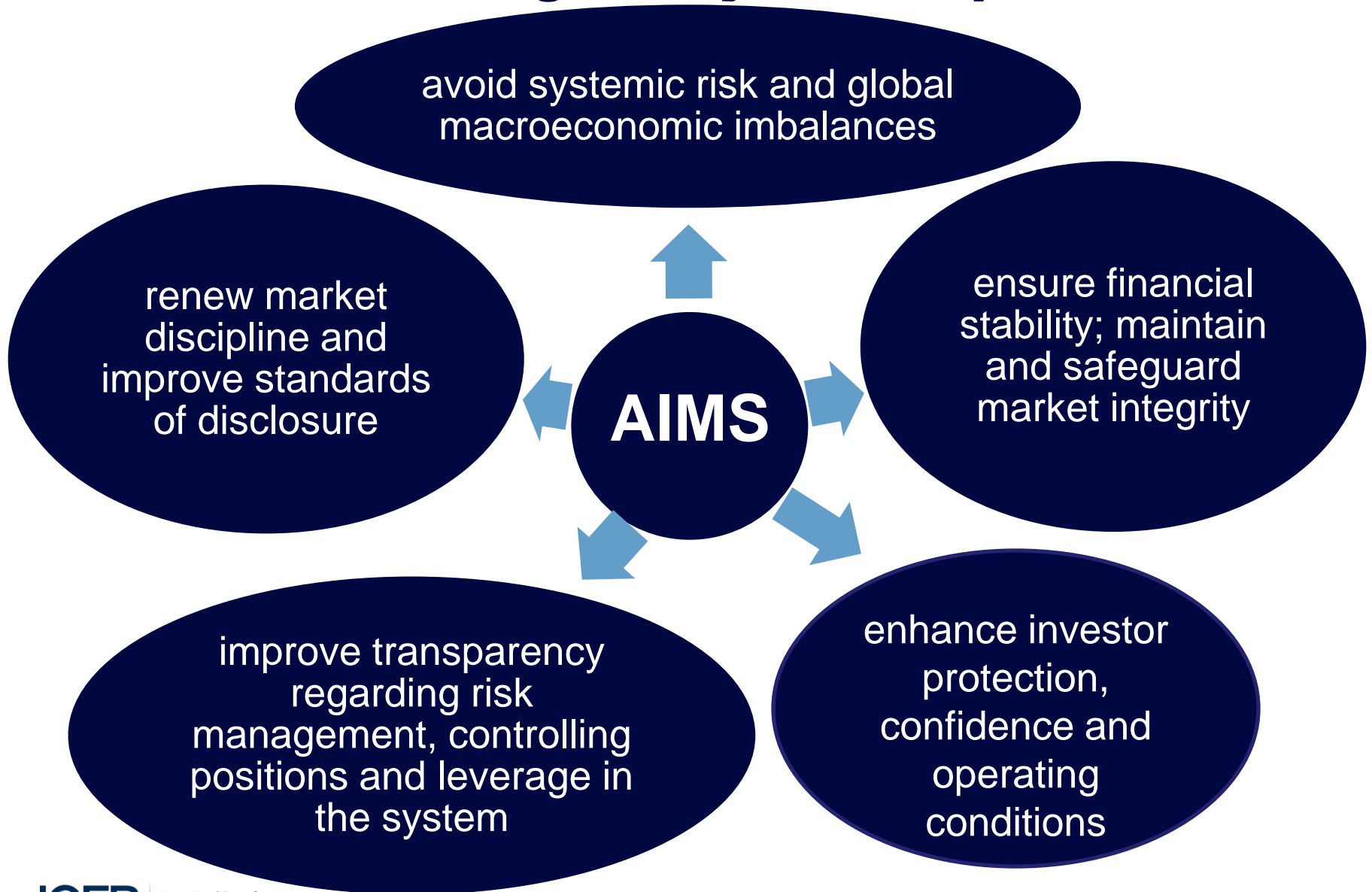
## Asset Support

Investing in financial assets & liabilities via purchases, guarantee underwriting and insurance policies to protect values, investor confidence and financial stability

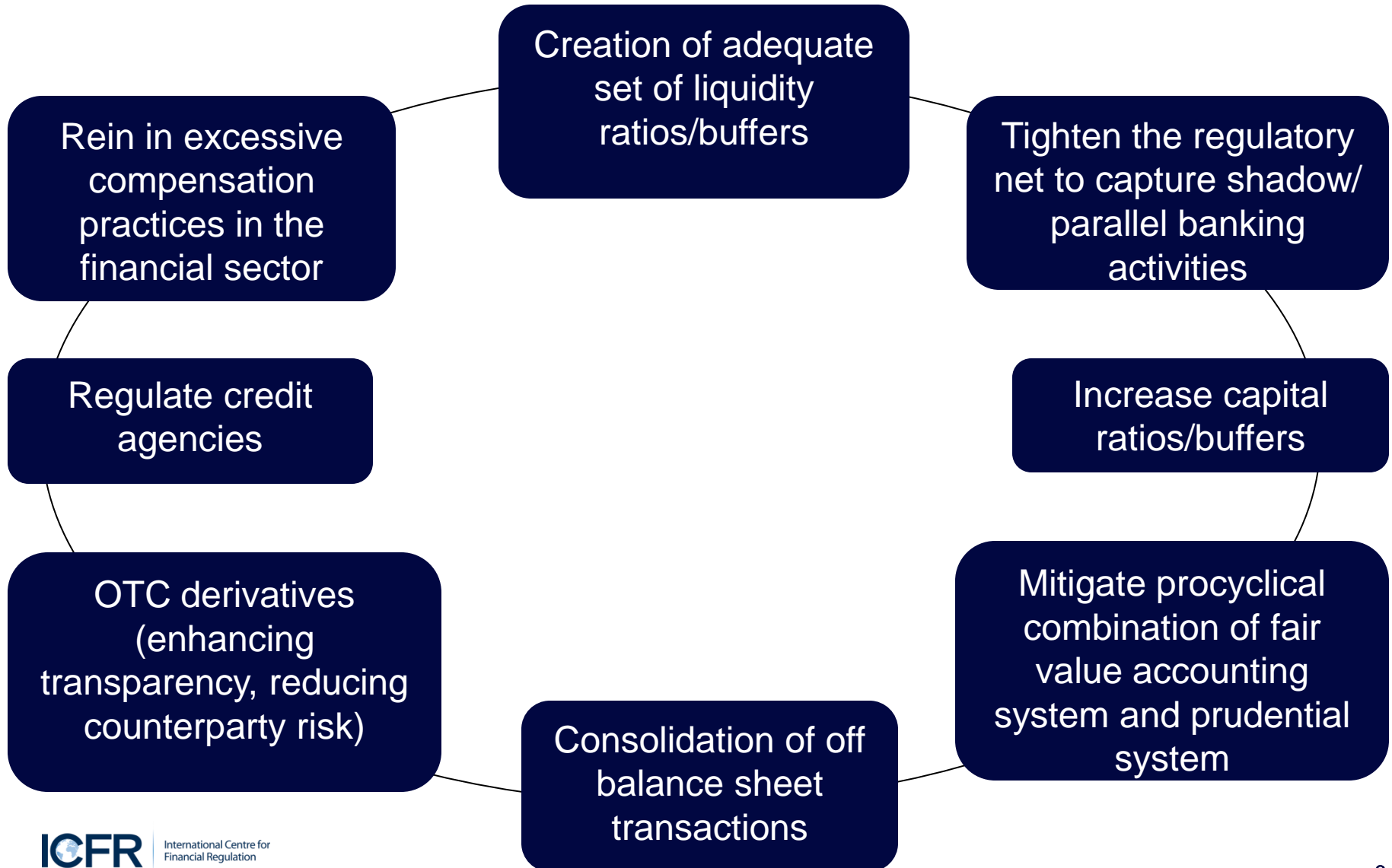
## Institutional Recapitalisation

Via government investment (debt & equity) in individual financial institutions to protect values, investor confidence and financial stability

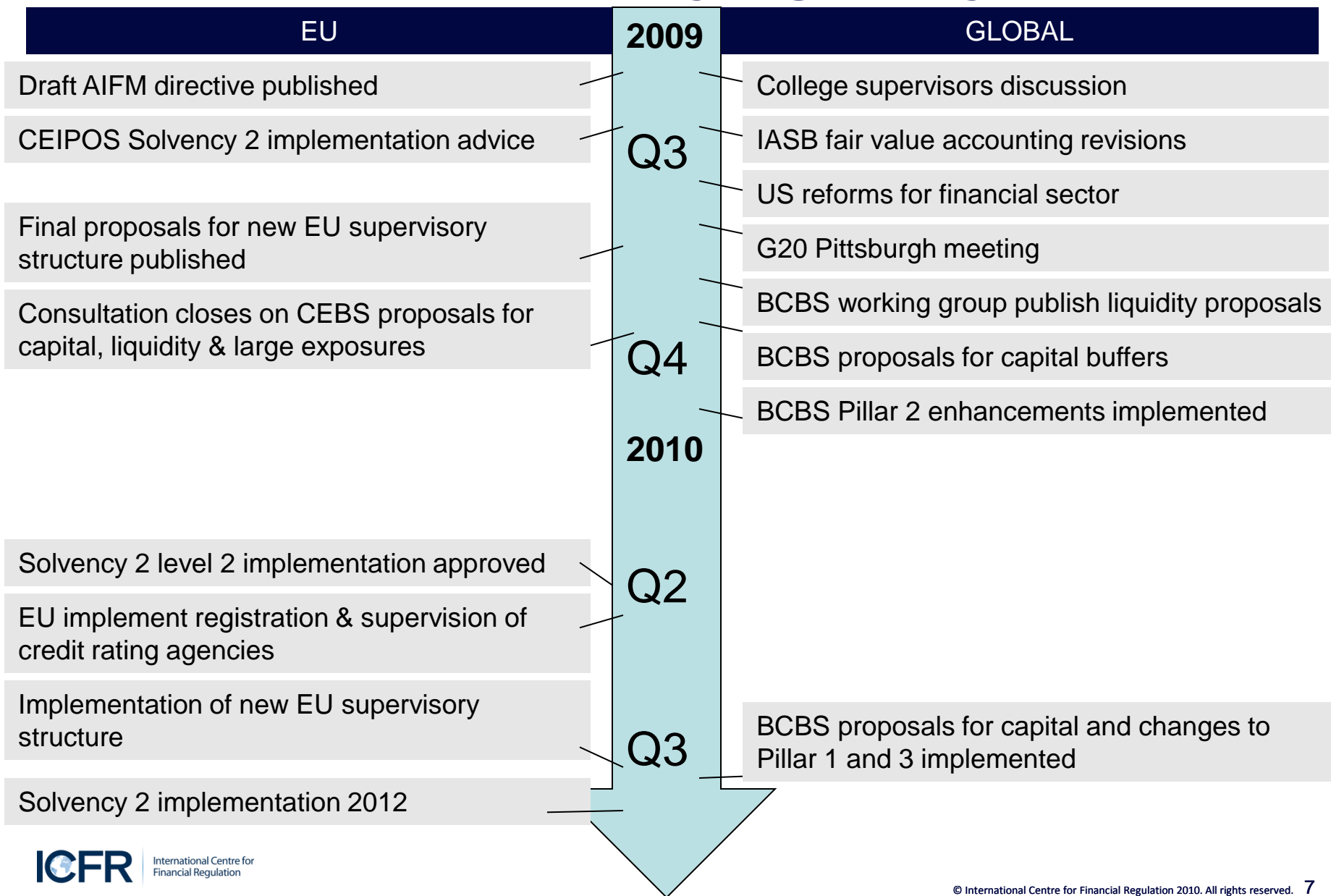
# Aims of the new regulatory landscape



# Common threads in global reform proposals



# Overview of 2009/2010 key regulatory milestones



# EU - key regulatory areas for repair

Stronger macroeconomic policy & macroprudential analysis

Assessment of asset bubbles and tightening monetary policy when money or credit grow in an unsustainable way.

Reforming the Basle 2 capital requirement process for bank capital

Capital counter-cyclical approaches – greater and higher quality capital buffers; Greater capital for trading books; measuring and limiting liquidity risk; stricter rules for off-balance sheet vehicles; common definition of own funds.

Parallel banking system (Hedge funds, private equity)

Regulation & supervision of systemic activities; information requirements on hedge funds should become mandatory – through regulation of hedge fund managers – AIFM directive.

Credit rating agencies (CRA's)

Supervised by new European Securities Authority; fundamental review of role of CRA's in the financial system; distinct new approach to rating of securitised products.

# EU - key regulatory areas for repair (cont...)

## Investment funds

Common EU rules should be strengthened – including tighter control over depositories and custodians.

## Securitised products/derivative markets

Derivative products should be standardised and simplified; at least one well-capitalised clearing house for credit default swaps should be created in the EU.

## Accounting

Strengthened governance of the IASB and improved valuation techniques.

## Insurance

Solvency II reforms and appropriate safeguards to be defined to ensure an effective group support regime.

## Sanctions / supervisory powers

To be strengthened throughout the EU – so sanctions bite and are deterrent.

# EU reforms – key regulatory proposals

Measure	Purpose	Status
<p>Amendments to the Capital Requirements Directive (2006/48/EC and 2006/49/EC)</p>	<p><b>Adopted:</b> New rules on securitisation; large exposures; home-host relationships; ‘hybrid’ capital; liquidity risk management.</p> <p><b>Proposed:</b> Increased capital requirements for trading books and re-securitisations; increased disclosure demands for securitisation exposures; restrictions on remuneration policies.</p> <p><b>Pending proposals:</b> Supplementary measures on capital and liquidity requirements; implementation of new leverage ratio pending from Basel Committee; elimination of national options and discretions; framework for counter-cyclical buffers.</p>	<p>These technical amendments were adopted in early 2009: their implementation is due by Dec 2010.</p> <p>The Commission proposed to further amend the CRD in July 2009. Implementation of these proposals is due by 2011.</p> <p>Following a public consultation in the autumn of 2009, proposals were published in Dec 09.</p>

# EU reforms – key regulatory proposals (cont...)

Measure	Purpose	Status
<p>Consultation on Possible Initiatives to Enhance Resilience of OTC Derivatives Markets</p>	<p>To enhance the resilience of OTC Derivatives Markets by:</p> <ul style="list-style-type: none"> <li>• Promoting further standardisation;</li> <li>• Strengthening the bilateral collateral management for non-CCP eligible contracts;</li> <li>• Enhancing the use of central data repositories;</li> <li>• Moving clearing of standardised OTC derivatives to CCPs;</li> <li>• Increasing transparency of prices, transactions and positions; and</li> <li>• Moving (part or all of) trading to public trading venues.</li> </ul>	<p>3 July 2009: Commission adopted a Communication analysing the benefits and risks of derivatives markets and their role in the financial crisis.</p> <p>3 July-31 Aug 2009: it staged a consultation, culminating in a high-level conference that took place on 25 Sept 2009.</p> <p>20 Oct 2009: it adopted a Communication setting out future policy actions. It will come forward with legislative proposals in 2010.</p>

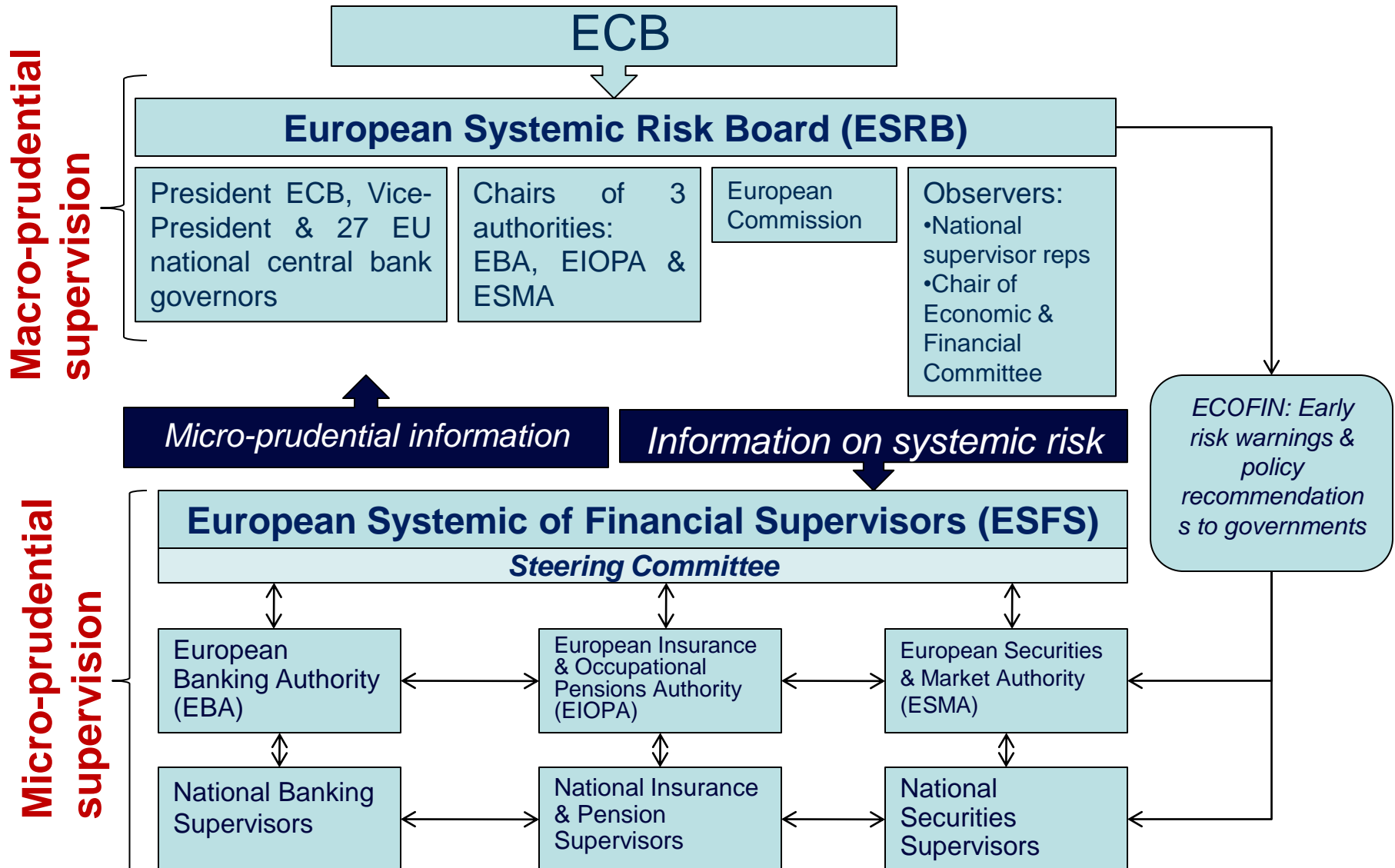
# EU reforms – key regulatory proposals (cont...)

Measure	Purpose	Status
Adoption of the Regulation on Credit Ratings Agencies	<ul style="list-style-type: none"> <li>• Enhance disclosure requirements;</li> <li>• Require registration of CRAs;</li> <li>• Improve quality of ratings; and</li> <li>• Eliminate conflicts of interest.</li> </ul>	This directly applicable regulation was approved by Council and Parliament in April 2009. Member states were to implement by Oct 09.
Draft Alternative Investment Funds Managers (AIFM) Directive	<ul style="list-style-type: none"> <li>• Establish a secure and harmonised framework for supervising risks that AIFMs pose to investors, counterparties, other market agents and overall financial stability; and</li> <li>• Permit, subject to compliance, AIFM to provide services and market their products across the internal market.</li> </ul>	Commission proposals were put forward in April 2009. Proposals are currently under consideration by the Parliament and Council. The Parliament's economic and monetary affairs committee are expected to vote on an amended draft in April 2010.
Proposed Review of the Markets in Financial Instruments Directive (MiFID)	To investigate whether, by leading to a significant migration of share trading transactions to unregulated OTC broker-dealer venues, the MiFID Directive has allowed these operators to enjoy unfair commercial advantages, which in turn serve to undermine price discovery and market integrity and efficiency.	A review of this Directive was due at the end of 2009.

# EU reforms – supervisory proposals

Measure	Purpose	Status
European Systemic Risk Board (ESRB)	<ul style="list-style-type: none"> <li>• Introduce macro-supervision function;</li> <li>• Act as early risk warning system; and</li> <li>• Liaise with international counterparts.</li> </ul>	Commission adopted a package of legislation on 23 Sept 09. It is currently under negotiation at the European Parliament and Council.
European System of Financial Supervisors (ESFS), comprising national supervisors plus three new European Supervisory Agencies (ESA) <ul style="list-style-type: none"> <li>•The European Banking Authority</li> <li>•The European Insurance Authority</li> <li>•The European Securities Markets Authority</li> </ul>	<ul style="list-style-type: none"> <li>•Harmonise supervisory practices;</li> <li>• Move towards single rulebooks;</li> <li>• Strengthen oversight of cross-border and pan-European entities;</li> <li>• Establish central database of microprudential information; and</li> <li>• Ensure a coordinated response to crises.</li> </ul> <p>The ESFS will share information with the ESRB for macro-prudential purposes. The ESRB will in turn issue risk warnings to the ESAs and any members states or groups of member states which it feels are endangering financial stability.</p>	ESFS was also proposed in the 23 Sept. 09 Commission package. Supplementary proposals, amending existing directives to make them compatible with the new system, were issued in October 09. The ESAs are expected to be established as regulatory agencies under EU law, based on Article 95 of the EU Treaty.

# The proposed EU supervisory structure



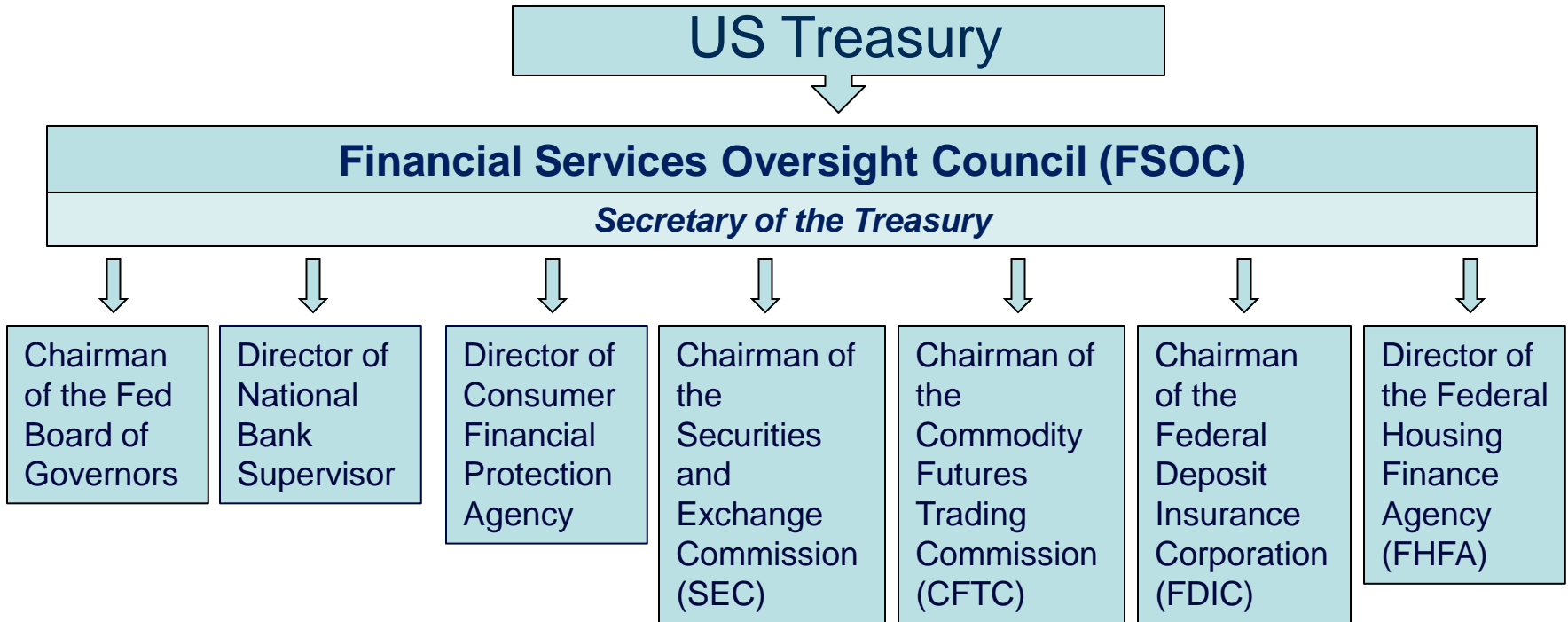
# US regulatory reform programme

17 June 09  
Obama

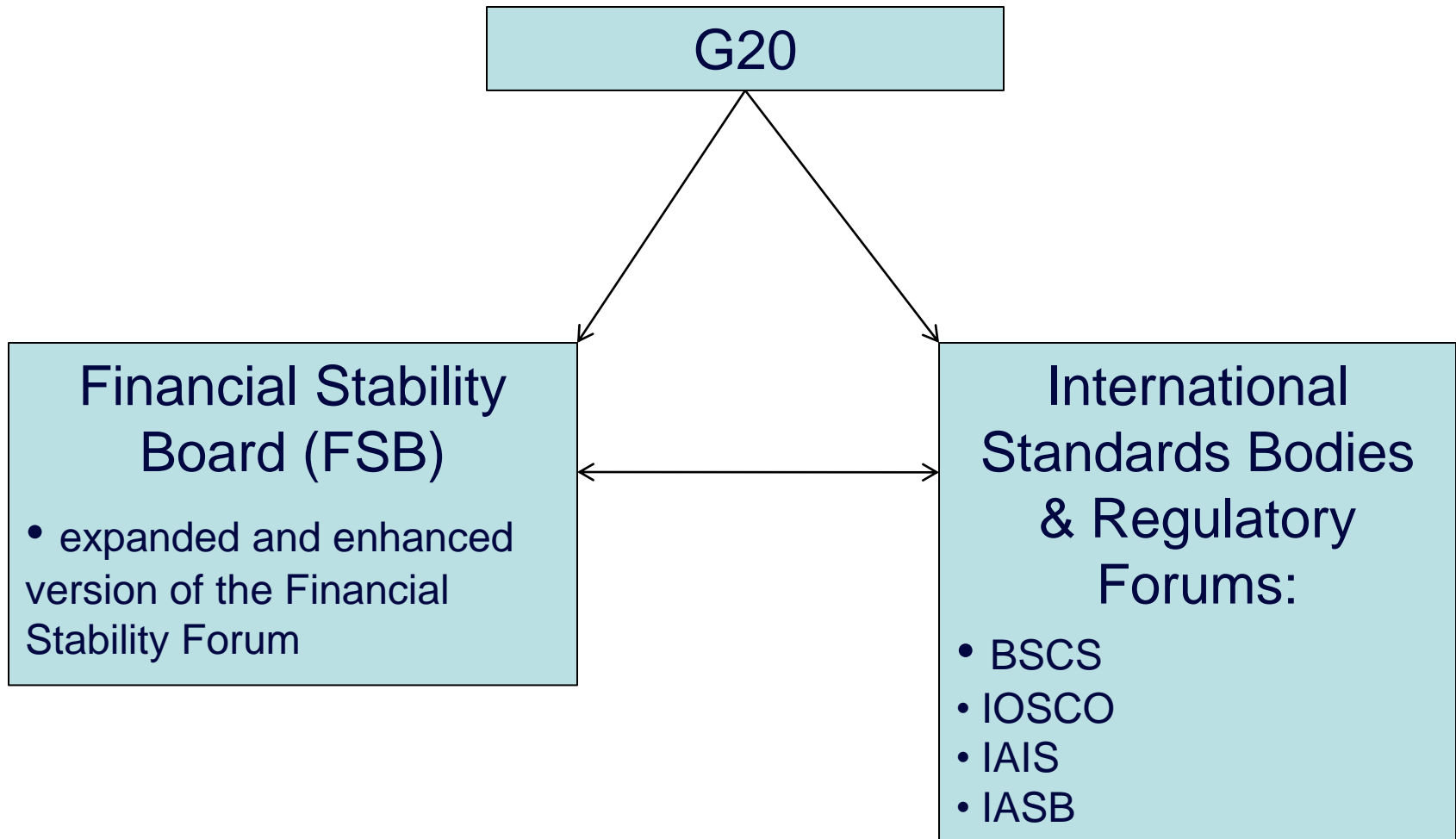
“Financial Regulatory Reform - A New Foundation: Rebuilding Financial Supervision and Regulation” white paper issued by the US Treasury Department

- Supervision of financial institutions – creation of Financial Services Oversight Council
- Strengthen prudential requirements for banks and bank holding companies
- Regulation of private funds (hedge funds and private equity)
- Regulation of OTC derivatives (payment, clearing and settlement systems) and securitisation markets
- Enhanced enforcement
- Address need for federal regulation of insurance industry

# The proposed US supervisory structure



# International institutional framework



# G-20 Principles - London, April 2009

Strengthening  
transparency and  
accountability

Enhancing sound  
regulation

G-20  
principles

Promoting integrity  
in financial markets

Reinforcing  
international  
cooperation

# G-20 Core Values - Pittsburgh Summit, Sept. 2009

Sound macroeconomic policies re long term economic objectives and avoid global imbalances

Reject protectionism, support open markets, foster fair and transparent competition, promote entrepreneurship and innovation



Financial market functionality via propriety, integrity and transparency leading towards efficient allocation of resources for sustainable economic performance

Strengthening oversight, transparency and accountability whilst ensuring the international economic and financial architecture reflects changes in the world economy and new challenges of globalisation



# FSB Progress Report to G-20 – Nov 2009

## (1) Building high quality capital and mitigating procyclicality

BCBS met in Oct 2009 re Basel II reforms

Revised definition of capital assessed in 2010 quantitative impact study

Capture of OTC derivative counterparty credit risk

Leverage ratio proposal and interaction with risk based ratio

Reduce pro-cyclicality of Basel II and propose a counter-cyclical buffer mechanism

- proposal to dampen cyclicity of minimum capital requirements (end 09)
- proposal to promote more forward looking provisioning (end 09)
- proposal to conserve capital to build up buffers which can be called up in times of stress (end 09)
- proposal to contain excess credit growth and protect the banking sector from system wide risk (middle of 2010)

Proposal for a new global liquidity standard

- finalised at BCBS meeting in Dec 2009
- issued for comment in early 2010
- will be subject to an impact assessment

# FSB Progress Report to G-20 – Nov 2009 (cont...)

## (2) Implementation of sounder risk management practices

Senior Supervisors Group (SSG) Oct 09 report re self assessment of 21 financial institutions risk management practices against official recommendations

SSG report re funding and liquidity issues central to the crisis

- short term tripartite repos to fund longer term illiquid assets
- deposit vulnerability due to market perception
- near cessation of interbank funding

SSG report flagged weakness in

- governance
- firm management
- risk management
- internal control programs



- failure of board and senior management to establish and adhere to acceptable risk levels
- compensation systems which conflicted with control objectives of the firm
- inadequate and fragmented technological infrastructure that hindered effective risk identification and management
- institutional arrangements that conferred status and influence on risk takers at the expense of risk management and control personnel

# FSB Progress Report to G-20 – Nov 2009 (cont...)

## (3) Strengthening accounting standards

Expected loss provisioning



- 5 Nov 09: IASB issued for public comment an exposure draft on expected loss provisioning
- comment period lasts 8 months (July 2010)
- new joint IASB and US FASB expert advisory panel to assist boards with credit impairment provisioning approaches to be established

Fair value measurement and lending activities



- July 2009 ED on classification and measurement of financial instruments changed due to stakeholder comments
- final standard will have a stronger consideration of a company's business model in determining whether a financial instrument should be fair value or amortised cost category
- final standard will allow securitised assets to be reported at amortised cost when cash flows and risks are like loans
- final standard will require reclassifications of financial assets when business model changes
- final standard to be published in Nov 09 and to be used for 09 annual reports

Converged netting rule and repo treatment approaches



- IASB plans to address convergence of standards on the netting of assets and liabilities and treatment of repurchase agreements as part of the IASB derecognition project

# FSB Progress Report to G-20 – Nov 2009 (cont...)

## (4) Reforming compensation practices

FSB Principles for Sound Compensation Practice Standards



- standards will be reflected in the EU Capital Requirements Directive
- France, Hong Kong, Italy, Switzerland, UK, US and other FSB countries have announced intention to implement the standards
- Oct 09: BCBS set up a senior supervisors group to discuss issues and share experiences regarding implementation of FSB standards
- Oct 09: assessment methodology for firm practices and assessing firm compliance

International Association of Insurance Supervisors



Is developing supervisory remuneration standards based on FSB principles for the insurance industry

IOSCO



Looking at disclosure, the decision making process and compensation characteristics as part of its Principles for Periodic Disclosure by Listed Entities. Due to be published in early 2010

FSB peer review



FSB will undertake a thematic peer review of actions taken by firms and national authorities to implement the FSB Principles for Sound Compensation Practice Standards. Review is to be completed by March 2010

# FSB Progress Report to G-20 – Nov 2009 (cont...)

## (5) Improving OTC derivatives markets

OTC Derivatives' Regulators Forum

- established in Sept 2009
- close to finalising an international cooperative oversight framework for the Trade Information Warehouse (the only CDS trade depository)

Committee on Payment and Settlement Systems and IOSCO review of existing standard for central counterparties

review to ascertain risks associated with clearing OTC derivatives and to be completed by mid - 2010

Commission Oct 09 proposals

- legislation to be introduced in 2010; impact assessments to occur
- reduction of counterparty risk via centralised counterparties being used for standardised contracts, higher capital and higher margin requirements for remaining bilaterally cleared contracts
- reducing operational risks by greater standardisation of legal terms
- improving transparency via use of trade repositories and mandating trading of standardised derivatives on exchanges or other venues
- enhancing oversight, giving regulators ability to set position limits to counter disproportionate price movements or concentrations of speculative positions


US legislation / reform proposals

needs to be coordinated to global implementation of new rules to ensure a level playing field and to address market fragmentation concerns

# FSB Progress Report to G-20 – Nov 2009 (cont...)

## (6) Cross-border resolutions and systemically impt firms

FSB measures on the “too big too fail” (TBTF) problems of systemically important firms (SIFIs)



- to be published by the end of Oct 2010
- FSB engaged in 3 approaches
  - *reducing probability and impact of failure* (looking at how regulators and supervisors deal with TBTF/SIFIs, examining SIFI funding and capital arrangements and legal and operational structures)
  - *improving resolution capacity* (policies for orderly resolution, ex ante crisis preparedness, contingency planning, cooperation and information exchange)
  - *strengthening the core financial infrastructures and markets* (considering improvements to infrastructures and measures to reduce contagion risks)
- FSB to present interim report at June 2010 G-20 meeting in Canada
- final FSB report and recommendations made in Oct 2010

# FSB Progress Report to G-20 – Nov 2009 (cont...)

## (7) Hedge Funds

EU and US  
legislation



- legislation for registration, reporting and oversight arrangements for hedge funds is advancing

IOSCO – June 09  
principles for  
regulation of hedge  
fund markets



- IOSCO to monitor progress in domestic regulation of the hedge fund sector and review how they align to IOSCO principles
- IOSCO Task Force on Unregulated Entities will produce a report in 2010 covering current changes at national and regional levels in hedge fund regulation as well as examine the adequacy of best practice standards. Report to be published in 1<sup>st</sup> quarter of 2010

# FSB Progress Report to G-20 – Nov 2009 (cont...)

## (8) Credit rating agencies (CRAs)

G-20 London summit aim



establish CRA regulatory oversight regime by end 2009

US proposed legislation in July 09



- to increase transparency, tighten oversight, reduce reliance on CRAs, reduce conflicts of interest at CRAs whilst strengthening SEC's authority over and supervision of CRAs.
- SEC adopted rules for greater information on ratings histories and to grant CRAs access to data for unsolicited ratings re unstructured products.
- SEC proposed rules for additional disclosure on potential conflicts of interest, material limitations on rating scope and whether there was rating shopping – rules were open for comment until Dec 09

EU legislation adopted by Council in July 09 and Parliament in Sept 09



- legislation covered oversight and supervision of CRAs
- CESR published consultation document on registration process and assessment of CRAs systemic importance on 21 Oct 09

## **ABOUT THE ICFR**

The ICFR is a global collaboration between key players in the private and public sector with backing from major international financial institutions and professional services companies, as well as the UK Government and the City of London Corporation. Its mission is to address the critical issue of international financial regulation by creating new thought leadership, research, scholarship and training for the financial industry. While based in the City of London the ICFR serves a global constituency.

Further information may be found at: [www.icffr.org](http://www.icffr.org).

**The International Centre for Financial Regulation is incorporated as a company limited by guarantee in England and Wales**

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