

Box 13

INITIATIVES AND MEASURES THAT ARE BEING TAKEN IN ORDER TO RESTORE CONFIDENCE AND STRENGTHEN FINANCIAL SYSTEM RESILIENCE

The turmoil in mature economy financial markets has revealed a number of weaknesses in the existing regulatory and supervisory framework worldwide. In response, competent authorities, international organisations as well as market participants themselves have launched several initiatives to identify the major causes of the turmoil and to develop responses aimed at restoring confidence and at strengthening the resilience of the financial system. In this connection, this box provides an overview of three streams of work that deserve special attention: the roadmap of the ECOFIN Council; the recommendations of the Financial Stability Forum (FSF); and initiatives that are being taken by the private sector.

The ECOFIN roadmap: at the EU level, the ECOFIN endorsed in October 2007 a roadmap, defining a list of actions in relation to the financial turmoil that are scheduled to be completed in 2008. The Council identified four priority areas for action: (i) enhancing transparency; (ii) improving valuation standards; (iii) reinforcing prudential rules and risk management in the financial sector; and (iv) improving market functioning. After the cut-off date of this issue of the FSR, on 14 May, progress on the roadmap as well as on the timeline was reviewed by the ECOFIN Council, and policy priorities for the short and medium term were confirmed.

The FSF recommendations: at the international level, the G7 Ministers and Central Bank Governors requested in October 2007 the Financial Stability Forum to draw the relevant lessons from the financial turmoil and to set out policy recommendations, with the aim of increasing the resilience of markets and institutions. After intensive consultation with international bodies and national authorities, the Report of the FSF on Enhancing Market and Institutional Resilience was discussed and endorsed at the G7 meeting on 11 April 2008. The report contains 67 recommendations, grouped in the following five main areas: (i) strengthening prudential oversight of capital, liquidity and risk management; (ii) enhancing transparency and valuations; (iii) changes in the role and uses of credit ratings; (iv) strengthening the authorities' responsiveness to risks; and (v) dealing with stress in the financial system. Within these broad categories, specific issues are also to be addressed, such as assessing the cyclicity of the Basel II framework; improving liquidity management of financial institutions; enhancing central bank monetary policy operational frameworks and crisis management arrangements; as well as improving cooperation and the exchange of information between authorities that are of particular importance also for central banks.

Private sector initiatives: in response to the financial turmoil, the Institute of International Finance (IIF) set up a committee to explore market best practices, with the aim of addressing current weaknesses and strengthening financial institutions so that they are better equipped to deal with future challenges. The interim report of the IIF has revealed that deteriorating lending and underwriting standards; excessive reliance on poorly understood ratings of structured products; difficulties in the valuation of illiquid assets; inadequate appreciation of the adverse implications of liquidity and reputational risk exposure of conduits and structured investment vehicles for sponsoring banks; as well as difficulties in identifying the final bearers of risks, were

among the major sources of the turbulence.¹ The detailed recommendations are planned to be published in summer 2008.

In addition to the IIF report, several other market initiatives that are aimed at addressing weaknesses in the securitisation process are also under way, including those of the European Securitisation Forum (ESF), the Securities Industry and Financial Markets Association (SIFMA) and the European Banking Federation (EBF). The major trade associations are working on identifying market best practices and have committed themselves to cooperate with authorities and other interested stakeholders to develop timely improvements in areas where shortcomings have been detected.

¹ Institute of International Finance (2008), “Interim Report of the IIF Committee on Market Best Practices”, April.