

Financial stability and depositor protection: cross-border challenges and responses

September 2008



HM TREASURY

**Financial stability and
depositor protection:
cross-border challenges
and responses**

September 2008

© Crown copyright 2008

The text in this document (excluding the Royal Coat of Arms and departmental logos) may be reproduced free of charge in any format or medium providing that it is reproduced accurately and not used in a misleading context. The material must be acknowledged as Crown copyright and the title of the document specified.

Where we have identified any third party copyright material you will need to obtain permission from the copyright holders concerned.

For any other use of this material please write to:

Office of Public Sector Information

Information Policy Team

Kew

Richmond

Surrey

TW9 4DU

E-mail: licensing@opsi.gov.uk

HM Treasury contacts

This document can be found in full on our website at:

hm-treasury.gov.uk

If you require this information in another language, format or have general enquiries about HM Treasury and its work, contact:

Correspondence and Enquiry Unit

HM Treasury

1 Horse Guards Road

London

SW1A 2HQ

Tel: 020 7270 4558

Fax: 020 7270 4861

E-mail: public.enquiries@hm-treasury.gov.uk

Printed on 100% recycled paper.

When you have finished with it please recycle it again.

ISBN 978-1-84532-418-6

PU625

CONTENTS

| | Page |
|---|-------------|
| Foreword | 3 |
| Chapter 1 Introduction | 5 |
| Chapter 2 Strengthening the stability and resilience of the global financial system | 9 |
| Chapter 3 Reducing the likelihood of banks facing difficulties | 17 |
| Chapter 4 Reducing the impact of a failing bank | 21 |
| Chapter 5 Providing effective compensation arrangements | 25 |
| Chapter 6 Improving coordination | 27 |

FOREWORD

Global financial markets bring enormous benefits to businesses and people across the world. They allow capital to be raised and invested more efficiently, risks to be managed more effectively, and wealth and savings to be stored and transferred – all of which is vital to the wider economy and society. The UK-based financial services sector has responded well to the opportunities provided by globalisation and has prospered from a longstanding tradition of openness and innovation. Despite the turbulence faced by world financial markets, it remains essential that the direction and pace of liberalising these markets is maintained as the basis for future prosperity.

However, the current market turbulence has shown us that, just as wider, bigger markets can help to manage risks, they also bring some new challenges for financial stability. The growing importance of cross-border firms brings with it new practical challenges for the authorities with responsibilities for guarding against risks to stability. The scale, complexity and cross-border nature of such businesses – straddling national boundaries and jurisdictions – all pose issues for central banks, finance ministries and financial supervisors in preventing, managing and resolving crises in global financial markets.

To tackle these issues we must ensure that we have the frameworks, legislation and practical arrangements to ensure that national authorities of all descriptions can work together effectively across borders. In light of recent experiences this paper sets out the views of the UK on these vital subjects. In parallel to the actions being taken within the UK, it proposes a series of steps to address internationally five objectives:

- strengthening the stability and resilience of the financial system – through, for example, pursuing the reforms proposed by the Financial Stability Forum in recent months, working with industry on the basis of the July 2008 report by the Institute of International Finance and the August 2008 report by the Counterparty Risk Management Policy Group III, and involving emerging markets through the UK's Chair of the G20 in 2009;
- reducing the likelihood of banks facing difficulties – the UK believes that the Lamfalussy arrangements continue to provide the most appropriate and effective means of regulating and supervising the EU's financial markets. These will be complemented by: ensuring that colleges of supervisors are in place to oversee cross-border firms more effectively, in the EU and further afield; ensuring that authorities are able to cooperate with each other; tackling obstacles to effective liquidity provision for cross-border banks; and ensuring that major cross-border financial infrastructures, on which the rest of the financial markets depend, such as payment, clearing and settlement systems, are overseen effectively;
- reducing the impact of a bank failing – despite the best preventative arrangements, banks will sometimes get into difficulties and, given the potential impacts elsewhere on the financial system, preparing for such circumstances and ensuring that international rules support effective resolution of these situations is important. Such arrangements must involve bringing together finance ministries, central banks and financial supervisors to make necessary preparations for management of crises in major cross-border banks;

- providing effective compensation arrangements – ensuring that national deposit guarantee schemes can deliver payouts efficiently and rapidly, while recognising the importance of reviewing the EU's arrangements for cross-border coverage of these schemes and in the mean time, ensuring effective and improved contingency arrangements for handling deposit compensation in the event of a cross-border bank failure; and
- improving coordination – ensuring that, at a national level, authorities are well equipped to engage effectively with their international counterparts, and that the various international institutions such as the International Monetary Fund and Financial Stability Forum work together effectively.

In the context of tackling these issues, the UK remains convinced that a single European supervisory authority offers no real advantage. The largest financial firms are global in nature, and nowhere more so than in London, where the flows of business with New York, Tokyo, Hong Kong and Dubai are as important as those with Paris, Frankfurt, Luxembourg or Dublin. Practical global solutions are needed to address the supervisory challenges that these flows pose. Rearranging responsibilities for financial supervision with a single EU authority would make little difference to our ability to oversee these risks. It would instead lead to centralised supervision, insufficiently close to the activities of the firms being supervised, and would be less able to allow for the differences in the EU's national legal systems and the risks in different local markets. As recent events have shown, responsibilities for financial stability in times of turbulence go much wider than those of financial supervisors, to involve national central banks, finance ministries and, potentially, deposit guarantee schemes. Simply changing lines of supervision would not provide a solution to the problems of providing liquidity assistance, deciding how to resolve a situation when a bank is in distress or reimbursing retail savings covered by national deposit guarantee schemes.

INTRODUCTION

1.1 Globalisation of financial markets has increased rapidly over recent decades. Facilitated by the twin drivers of liberalisation and technological change¹, it has become easier than ever before for financial firms and markets to operate across borders, leading to the growing emergence and importance of large, increasingly complex financial institutions operating on an international scale.

CHALLENGES

Benefits and challenges for stability

1.2 Financial integration brings benefits for financial stability, as risk is diversified more widely². However, the growing importance of cross-border firms and markets also brings with it some important new challenges for financial stability and for the authorities with responsibilities for it. The scale, complexity and cross-border nature of these firms and their activities – straddling national boundaries, legal jurisdictions and supervisory remits – present particular challenges to national authorities, in preventing, managing and resolving crises in financial markets. These challenges – and the need to have arrangements to deal with them – have been highlighted by the recent period of financial market turbulence. They have not simply been confined to retail banks as cross-border wholesale institutions, investment banks and insurers have also faced difficulties. Failures of such institutions run the risk of widespread consequences for the economy and could potentially harm consumers and investors worldwide.

1.3 This document identifies some of these challenges and presents possible responses to them, referring where possible to initiatives already underway at an international level – in the European Union (EU), the G7, the Financial Stability Forum (FSF), the International Monetary Fund (IMF) and the G20. In doing so, it draws on analysis and lessons from the UK's own experience of dealing with the financial market turbulence.

MARKET DEVELOPMENTS IN 2007 AND 2008

Banks' financial positions

1.4 Rising US sub-prime mortgage defaults in the second half of 2007 set in train a broad-based repricing of risk and deleveraging by banks and other financial market participants. The adjustment has been protracted and, as banks have been unable to secure funding on assets in which markets have been closed, uncertainty about banks' financial positions increased in the UK and abroad.

1.5 This uncertainty has undermined confidence in banks and generated reluctance among market participants to trade with each other. Liquidity has fallen sharply in some credit markets, including most prominently many asset backed securities markets, as well as structured credit markets and the leveraged loan market, contributing to falls in the market values of assets.

1.6 An adverse interaction between asset prices and banks' balance sheets has been evident in recent months across the world. As asset prices have fallen, the mark-to-market value of many financial firms' assets has also declined, leading to substantial write-downs at financial institutions. That has raised counterparty risk, in turn

¹ HM Treasury (2005). *The UK Financial Services Sector: Rising to the Challenges and Opportunities of Globalisation*

² International Monetary Fund (2007). *Reaping the benefits of Financial Globalisation*, IMF, Washington DC

contributing to continued strains in money markets. In response to funding difficulties, banks have tightened the availability of credit to households and companies.

1.7 In these conditions, adverse news and rumours have led to a decline in confidence in the resilience of individual institutions.

Credit markets **1.8** Since late March 2008 there have been tentative signs of re-emergence of activity in some credit markets. Several banks have disposed of some of the backlog of leveraged loans and asset backed security exposures. Banks globally – including the UK – have also moved to raise their capital buffers. Commensurate with these developments, corporate credit spreads and the costs of buying default protection on banks, have fallen back sharply from their peaks in mid-March. However, central bank lending surveys – including the Bank of England’s 2008 Q1 Credit Conditions Survey³ – suggest that tight credit conditions are likely to continue.

Interbank markets **1.9** Interbank funding markets remain under considerable strain. Although three-month interbank rates relative to expected policy rates remain below the peaks reached in September and December 2007, and have fallen back further following central bank actions, appetite among banks to lend to each other at longer maturities remains considerably limited and interbank rates remain elevated relative to expected future policy rates. Although pressures are expected to dissipate further over time, the future path of interbank rates is uncertain, and may depend heavily on the return of non-bank lenders – most notably money market funds – to short-term bank funding markets.

UK EXPERIENCE AND OBJECTIVES

Five objectives **1.10** In the UK, the Authorities with responsibility for financial stability – the Treasury, the Financial Services Authority (FSA) and Bank of England (‘the Authorities’) – have set out their recent analysis and proposals for change in a series of consultation papers⁴. They have identified five objectives for reform – supported by the results of consultation:

- strengthening the stability and resilience of the financial system;
- reducing the likelihood of individual banks facing difficulties;
- reducing the impact if, nevertheless, a bank does get into difficulties;
- providing effective compensation arrangements in which consumers have confidence; and
- strengthening the Bank of England and ensuring effective coordinated actions by the Authorities.

1.11 The work by the Authorities has, to date, focused primarily on those markets and institutions for which they have greatest responsibility and ability to act – that is, UK-based institutions. It has also focused chiefly on the banking sector – where the most significant difficulties have been faced during the recent market turbulence – while recognising that similar issues could arise in other parts of the financial sector.

³ Available at <http://www.bankofengland.co.uk/publications/other/monetary/creditconditionssurvey080403.pdf>

⁴ Bank of England, HM Treasury, Financial Service Authority (January 2008). *Financial stability and depositor protection: strengthening the framework* and Bank of England, HM Treasury, Financial Service Authority (July 2008). *Financial stability and depositor protection: further consultation*

The work has highlighted that there are further challenges involved in dealing with problems in cross-border institutions⁵.

Agenda 1.12 This paper addresses these challenges. It uses broadly the same approach as the UK-focused work, given that the underlying objectives are essentially the same: to aim to prevent firms getting into difficulty and to have the arrangements to manage those difficulties in the event that they do, nevertheless, arise. It is intended to inform and stimulate debate within international fora this autumn.

INTERNATIONAL CONTEXT

Need for international approach 1.13 London is the world's largest international financial centre, the centre of the interbank lending market, with over 260 branches of foreign banks, and the location for over one-third of the world's foreign exchange business⁶. UK financial businesses have global footprints, with HSBC and RBS for example operating in 83 and 53 countries and territories respectively⁷, while consumers in the UK are served by retail banks from countries as diverse as India, Nigeria and Brazil, as well as countries in the EU such as Spain, the Netherlands and Ireland. Given this, the UK fully supports a wide-ranging approach to international cooperation, in particular, with those countries where the decision-making has significant bearing on the stability of individual firms and markets. It is essential to achieve cooperation with other major global financial centres and, given the rapid changes in many emerging markets⁸, to broaden these discussions beyond the major developed economies, including through the G20, the FSF and the IMF.

Actions under way 1.14 The challenges to financial stability presented by cross-border firms and the associated difficulties of dealing with them have been widely recognised internationally, with increasing action over recent months, including:

- within the EU and the wider European Economic Area (EEA), amendments in 2008⁹ to the Memorandum of Understanding between finance ministries, financial supervisors and central banks of 2005¹⁰, including reference to establishing new cross-border stability groups;
- within the FSF, including its work on enhancing market and institutional resilience¹¹ and its recent report to G7 finance ministers¹²; and
- through multilateral agreements and actions between financial supervisors around the world, in particular building on the supervisory colleges that already exist, to strengthen, develop and extend these further.

⁵ Bank of England, HM Treasury, Financial Service Authority (January 2008). *Financial stability and depositor protection: strengthening the framework* (Paragraphs 1.13, 1.56 and 7.18)

⁶ HM Treasury (2006). *Financial Services in London: Global opportunities and challenges*

⁷ Information from HSBC Group and RBS Group 2007 Annual Reports and Accounts

⁸ HM Treasury (2005). *The UK Financial Services Sector: Rising to the Challenges and Opportunities of Globalisation* (Paragraph 3.44)

⁹ *Memorandum of Understanding on Cooperation between the Financial Supervisory Authorities, Central Banks and Finance Ministries of the Europe Union on Cross-Border Financial Stability* (2008)

¹⁰ *Memorandum of Understanding on co-operation between the Banking Supervisors, Central Banks and Finance Ministries of the European Union in Financial Crisis situations* (2005)

¹¹ Financial Stability Forum (April 2008). *Enhancing Market and Institutional Resilience: Report to the G7 Finance Ministers and Central Bank Governors*

¹² Financial Stability Forum (June 2008). *Update on the Implementation of the FSF's Recommendations: Report by the FSF Chairman to the G7 Finance Ministers*

2

STRENGTHENING THE STABILITY AND RESILIENCE OF THE GLOBAL FINANCIAL SYSTEM

GLOBAL STANDARDS AND REGULATION

Supporting the work of the FSF

2.1 The regulation of financial markets has increasingly been based on principles, rules and standards set internationally, assisting the liberalisation of markets and the better management of risk across borders. It is right, therefore, that the international community is taking steps to strengthen the stability and resilience of the global financial system by ensuring that such rules are reformed where necessary. In this respect, the Authorities support the work of the FSF, which has focused attention on¹³:

- strengthening prudential oversight of capital, liquidity and risk management, through co-ordinated action by national and international bodies, particularly the work of the Basel Committee on Banking Supervision¹⁴ to strengthen the Basel II capital requirements for structured credit and securitisation activities and through enhanced supervision of liquidity and risk management;
- enhancing transparency and valuation in securitisation markets through robust risk disclosures by financial institutions and accelerated work by the International Accounting Standards Board (IASB) to enhance accounting and disclosure standards related to off-balance sheet entities and the valuation of structured products;
- changes to the role and uses of credit ratings, including improvements by credit rating agencies in: the quality of the rating process, including managing conflicts of interest; expanded information on structured products, including differentiated ratings for corporate and structured finance products; and the enhanced assessment of underlying data quality; and
- strengthening authorities' responsiveness to risks and arrangements for dealing with stress in the financial system.

Update

2.2 The UK continues to support fully and play a leading role in these initiatives in the EU, the FSF, the G7, the G20, the Basel Committee on Banking Supervision, the International Organisation of Securities Commission (IOSCO) and other international fora. In July 2008 the UK set out the steps it is taking, both domestically and with its international partners, to implement the FSF recommendations in more detail¹⁵. Since then, there have been a number of further developments in relation to regulatory proposals and to cross-border cooperation, which are discussed below.

2.3 Much of the work in these fora has so far addressed the retail banking sector on which this paper focuses. However, it is important to bear in mind that wholesale market institutions, investment banks and insurers, which are increasingly large and

¹³ Financial Stability Forum (April 2008). *Enhancing Market and Institutional Resilience: Report to the G7 Finance Ministers and Central Bank Governors*.

¹⁴ The Basel Committee on Banking Supervision provides a forum for regular cooperation on banking supervisory matters. Its objective is to enhance understanding of key supervisory issues and improve the quality of banking supervision worldwide. The Committee's members come from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom and the United States. Countries are represented by their supervisory authority and also, where that authority is not a central bank, by their central bank.

¹⁵ Bank of England, HM Treasury, Financial Service Authority (July 2008). *Financial stability and depositor protection: further consultation*.

complex, and subject to broadly the same cross-border issues, have also experienced difficulties.

REGULATORY DEVELOPMENTS SINCE JULY 2008

2.4 Since the July consultation, the following noteworthy developments have taken place:

- on 16 April the European Commission proposed a series of draft amendments to the Capital Requirements Directive (CRD)¹⁶. The UK has emphasised the importance of delivering a proportionate package of changes to the CRD supported by market failure analysis and impact assessment in line with better regulation principles¹⁷. Further details are set out in Box 2.1;
- on 8 July the EU's Economic and Financial Affairs Council (ECOFIN) agreed to support the objective of introducing a strengthened oversight regime for credit rating agencies (CRAs). The Council also agreed, without prejudice to the consideration of its practical application, to support the principle envisaged by the European Commission that CRAs should be subject to an EU registration system. On 31 July the European Commission launched a consultation on a draft regulatory proposal concerning CRAs. Further details on these proposals – and the Authorities' initial views – are set out in Box 2.2. The Authorities have responded to the European Commission's consultation and will continue working closely with their European and international partners to achieve an appropriate and consistent framework for monitoring CRAs;
- two major reports have been published by financial services industry representatives on the lessons to be learned from the ongoing market disruption. On 17 July the Institute of International Finance (IIF) Committee on Market Best Practice published its final report on steps that the international financial services industry should take to address weaknesses in business practices and market structures highlighted by recent events. The report sets out a number of principles of conduct and best practice recommendations for the global finance industry.¹⁸ On 6 August the Counterparty Risk Management Policy Group III (CRMPG III), comprising a small group of senior market participants, published its final report on the appropriate private sector response to the credit market crisis of 2007 and 2008¹⁹. **The Authorities encourage market participants to continue to work together in learning the lessons from the ongoing financial markets disruption and in implementing appropriate solutions; and**
- the FSF is examining the forces that contribute to pro-cyclicality in the financial system, including potentially the interaction between accounting standards and prudential rules, and possible options to mitigate this. Related work is underway at the International Accounting Standards Board

¹⁶ European Commission (2008). *Public consultation on possible changes to the Capital Requirements Directive*

¹⁷ In addition, the Solvency II framework of prudential regulation of the insurance and reinsurance sector will introduce risk-based capital requirements for insurers and enhance the quality of their risk management, contributing to the resilience of the overall financial system.

¹⁸ Institute of International Finance (2008). *Final Report of the IIF Committee on Market Best Practices: Principles of Conduct and Best Practice Recommendations*

¹⁹ Counterparty Risk Management Policy Group III (2008). *Containing Systemic Risk: The Road to Reform*

Box 2.1: European Commission consultation on potential changes to the Capital Requirements Directive

The Basel Committee agreed the original Basel Accord in 1988, the purpose of which was to create an international standard that banking regulators could use when developing regulations about how much capital banks need to put aside to guard against financial and operational risks.

Basel II in 2004 revised the existing framework to make it more risk sensitive and representative of modern banks' risk management practices. It included explicit capital requirements for operational risk (risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events) and more risk sensitive capital requirements against credit risk. It also allowed firms to calculate, within certain constraints, their own credit risk weightings, and subjected them to supervisory review and disclosure requirements. One of the aims of the new framework was to leave the overall level of capital held collectively by banks broadly unchanged.

The Capital Requirements Directive (CRD) implements the Basel II accord in EU law and came into force on 1 January 2007^a. Through its negotiation in the EU, a number of issues were set aside pending a more detailed review. The review now under way aims to strengthen financial stability, simplify and clarify elements of the Directive and learn lessons from the recent financial market disruption, covering, among other issues, four key areas:

- large exposures – regarding the maximum exposure a financial institution can have to a single entity or related group of entities, including exposures within a group and between banks;
- definition of capital – clarifying the type and quality of the capital financial institutions are required to hold as a buffer against potential losses;
- supervisory arrangements – aiming to strengthen supervisory coordination by improving cooperation and information exchange and reinforcing the efficiency and effectiveness of supervision of cross-border banking groups; and
- incentive structures in the 'originate to distribute' model – where banks do not hold the loans they originate but repackage and securitise them. The European Commission ran a second consultation on amendments in this area during July 2008.

Following consultation in April 2008, the European Commission will submit its revised proposal to the Council of Ministers and the European Parliament for discussion towards the end of September. Ahead of this, the Treasury, the Bank of England and the FSA have been engaging actively with stakeholders to develop their position.

The UK encourages the European Commission to deliver a balanced package that improves financial stability, simplifies and clarifies some elements of the Directive and is a proportionate response to recent financial market disruption. It will be important that forthcoming proposals follow the European Commission's better regulation agenda, and are underpinned by rigorous market failure analysis and a full impact assessment. In particular, the UK in line with other Member States has concerns about the European Commission's recent draft securitization consultation, where the proposals, as drafted, could have significant adverse impacts on the competitiveness of the EU's financial markets.

^a The most advanced approaches for credit and operational risk were only available to banks from 1 January 2008.

(IASB), Basel Committee on Bank Supervision and Committee of European Securities Regulators (CESR) on valuation and disclosure issues, including the valuation of illiquid assets. Effective cross-border co-operation between

standard setters, supervisors, users and co-ordinating institutions such as the FSF is necessary to respond to issues raised by the development and application of global standards. The trustees of the International Accounting Standards Committee Foundation are reviewing the constitution of the Foundation to improve its transparency and public accountability, which will help improve co-ordination of the global standard setting and implementation processes.

Box 2.2: Credit rating agencies

On 31 July the European Commission launched a consultation on a draft Directive concerning the authorisation, operation and supervision of credit rating agencies (CRAs) in the EU and policy options to address the problem of excessive reliance of investors on credit ratings.

Regarding the proposed registration regime for CRAs, the Commission's proposals include:

- a set of substantive requirements aimed at ensuring appropriate management by CRAs of conflicts of interest, encouraging improvements in the quality of CRA outputs and increasing transparency of CRAs' activities; and
- two options for the authorisation process and supervisory architecture for CRAs: (i) a national authorisation and supervision process, with a compulsory consultation and designation role for CESR in determining the home Member State competent authority and strong involvement of other competent authorities; and (ii) the creation of a European Community Agency responsible for the authorisation process with supervision by national regulators.

The UK supports the objective of introducing a registration regime for CRAs operating in the EU subject to resolving practical considerations. The UK believes that it is important to ensure that the substantive provisions applying to CRAs are proportionate, principles- and risk-based and that, consistent with the Council Conclusions of the ECOFIN meeting of 8 July, due consideration is given to their potential impact on competition between CRAs. Given the global nature of CRAs' business there are considerable benefits to an internationally consistent solution to avoid regional differences in standards. The IOSCO Code of Conduct Fundamentals for Credit Rating Agencies, recently revised, after extensive consultation to address concerns about CRAs' activities in the markets for structured products, provides a benchmark for the conduct of business standards that CRAs should be expected to meet.

The UK believes that a number of changes should be made to the substantive requirements on CRAs in the Commission's draft to ensure that they are proportionate, do not create undesirable incentives for investors to rely excessively on credit ratings, do not damage competition in the CRA sector and that, as far as possible, the registration regime is consistent with the IOSCO Code. The Commission should carefully consider whether the divergences from the IOSCO Code that they have proposed are necessary to achieve the objectives of the registration regime.

Regarding the authorisation regime and supervisory architecture, the UK does not support options that would give CESR a decision-making role or the creation of an Agency, and note that both options would be inconsistent with the Council Conclusions of the ECOFIN meeting of 14 May 2008 on the EU's regulatory and supervisory architecture. The UK believes that consideration should be given to alternatives, in particular authorisation and supervision by a lead supervisor, determined on the basis of clear criteria, with an obligation for the lead supervisor to consult and share information with other competent authorities on an ongoing basis. A model based on the approach used in the existing so-called "ECAI" recognition regime (which applies to CRAs whose ratings are used by EU financial institutions for the purposes of calculating their regulatory capital requirements under the CRD) also merits consideration.

The second part of the European Commission's consultation considers policy options that might help to address concerns about excessive reliance by investors on credit ratings. The UK agrees that investors need to take steps to address their over-reliance on credit ratings. However, any policy proposals aimed at reducing investor reliance on credit ratings should be subject to thorough consultation and full regulatory impact assessment. Non-regulatory as well as regulatory measures should be considered.

EXTENDING CROSS-BORDER COOPERATION

2.5 Cross-border cooperation is vital to help deal more effectively with risks to financial stability. This needs to be addressed on a number of different levels and in different fora, including ensuring that the EU and FSF proposals are aligned. In addition, the UK believes the involvement of emerging markets should be extended and an effective early warning system should be developed.

Emerging economies

2.6 The UK supports the inclusion of key emerging economies in discussions about financial stability. Financial globalisation means the growth of some of these countries' markets – especially China and India – and their firms make them an increasingly important part of the global financial system, as shown in Box 2.3. This brings with it many opportunities and challenges for financial stability and therefore, **the UK proposes that alongside existing reforms it will:**

- throughout 2009 ensure that G20 members are involved and engaged in discussions about the stability and resilience of the financial system;
- support the evolution of the FSF's outreach programme, building on models such as the Basel Committee's International Liaison group, to deepen engagement; and
- encourage wider inclusion of emerging markets within the financial stability work programmes of the FSF and IMF.

Early Warning System

2.7 The UK continues to support the idea of a more effective early warning system (EWS) to identify international risks to financial stability, as set out in the January consultation²⁰. The UK envisages that such an EWS would be based on the analysis already carried out by the FSF and enhanced by the macroeconomic surveillance of the IMF.

2.8 Building on their current initiatives and working together, the FSF and IMF can achieve even more for global financial stability. As set out in the January consultation document²¹, the UK believes the IMF should identify the top risks and vulnerabilities to the international financial system, from a macroeconomic perspective, with an assessment of the potential impact and likelihood of each risk. The FSF should identify and report on the appropriate response by market participants and national and international regulators, to these risks and report on progress with mitigation actions. The intention would be to publicise widely this joint international financial stability monitoring report setting out the key risks, to ensure a greater understanding of vulnerabilities, and the need and options for mitigating actions.

2.9 For cooperation to be fully effective, the FSF should also:

- carry out a strategic coordinating role of the international regulatory and standard setting bodies to ensure international regulatory policy development is both coordinated and focused on priorities;
- develop mechanisms to increase interaction with the global financial services industry, to better understand the challenges it faces; and

²⁰ Bank of England, HM Treasury, Financial Service Authority (January 2008). *Financial stability and depositor protection: strengthening the framework*.

²¹ Bank of England, HM Treasury, Financial Service Authority (January 2008). *Financial stability and depositor protection: strengthening the framework*.

- raise the profile of its work in the international community, both in the public and private sector.

2.10 This would provide public and private sector decision-makers with forward-looking analysis of the developments in global financial markets that have potential to impact on the macro economy.

Box 2.3: The importance of emerging markets to the international financial system

The emerging economies currently hold about 14 per cent of global external financial assets, less than their share of global GDP, which exceeds 20 per cent. However, in the last five years, financial globalisation has increased most rapidly within and between the emerging economies. Capital flows into and out of these countries increased nearly 500 per cent between 2002 and 2006, from US\$173 billion to US\$990 billion. In India alone, flows rose from less than 32 per cent of GDP in 1992 to more than 90 per cent in 2006^a.

In recent years, many emerging economies have become significant net exporters of capital. Sovereign Wealth Funds (SWFs) have become an increasingly important part of the international financial system. SWFs are usually government-controlled foreign currency assets that are managed separately from official foreign exchange reserves. However, they are not a recent phenomenon: the first commodity-based SWF, the Kuwait Investment Authority, opened its office in London in 1953.

Sovereign wealth funds play an important stabilisation role in the global financial markets. They generally have long investment horizons and few commercial liabilities and therefore face fewer pressures to reduce the size or increase the liquidity of their investments. Moreover, they represent an important source of capital: since November 2007 alone they have provided around US\$40 billion of new capital to some of the world's largest commercial and investment banks.^b

The growth of major emerging market economies – particularly those of India and China – is shifting the global balance of economic activity^c and reshaping the global economy.^d Alongside this, the rapid expansion of emerging market financial sectors is reshaping the global financial system. The UK, through bilateral Economic and Financial Dialogues with India and China and its participation in EU and other multilateral discussions with these and other emerging markets, is already working to promote financial stability and expand emerging market opportunities within the global financial services industry.

As described, financial globalisation brings with it many opportunities – such as increased competition, investment diversification and the allocation of risk – but also a number of future challenges, such as the threat of contagion from developed or emerging countries. For example, the tremors caused by the Mexican crisis (1994-1995) and the Asian crisis (1997-1998) were felt around the world.

These developments and the threat of contagion call for a re-evaluation of the scope and remit of approach. In 1999 the G20 was created to improve cooperation on matters relating to the international financial system and the global economy. Use of the G20 forum to address these issues is hugely beneficial and consequently the UK will, throughout 2009, ensure that G20 members are fully involved and engaged in discussions about the stability and resilience of the financial system.

^a Indian Ministry of Finance (2007). *Making Mumbai an International Financial Centre*, Delhi

^b Bank of England (2008). *Sovereign Wealth Funds and Global Imbalances*, speech by Sir John Gieve, 14th March 2008

^c HM Treasury (2005). *The UK Financial Sector: Rising to the Challenges and Opportunities of Globalisation*

^d HM Treasury (2008). *Embracing Financial Globalisation*

3

REDUCING THE LIKELIHOOD OF BANKS FACING DIFFICULTIES

3.1 The work of the Authorities within the UK has focused particularly on three aspects of this objective: effective supervision, effective liquidity arrangements, and effective arrangements for overseeing financial infrastructure (specifically payment systems). There are important cross-border elements to all three of these issues. In addition it is important to ensure that international rules facilitate rather than hinder national authorities from carrying out their activities effectively.

EFFECTIVE SUPERVISION

3.2 The Authorities support steps to improve cooperation between supervisors on a global basis, both in the EU and elsewhere. The UK supports the following steps:

- **the establishment of supervisory colleges for all significant cross-border firms** to reinforce and improve supervisory cooperation. In the EU, ECOFIN has agreed they be established in EU legislation, and the FSF has called for their establishment for all major groups by end-2008²². The next clear step is therefore to implement and establish these colleges, and **the UK calls on other relevant authorities to prioritise this work;**
- **the focus now being on implementing the positive changes in the supervision roadmap, as requested by ECOFIN in May 2008.** This is intended to enhance and improve the Lamfalussy arrangements for national supervisors to cooperate with each other, rather than to give decision-making powers to centralised bodies; and
- effective cooperation between National Supervisors ensured by their governments, working towards greater convergence, as well as being able to have regard to financial stability issues in other jurisdictions. In the EU Member States have made a political commitment to ensure national supervisory mandates enable this. **The UK proposes that countries review their supervisory arrangements, to ensure that there are no barriers to their national supervisors cooperating with those in other countries and being able to have regard to the stability of global markets.** The FSA, given the global nature of London's financial markets, will continue to have regard to both the EU and global dimension when carrying out its role.

3.3 The so-called Lamfalussy Level 3 Committees²³ – made up of national supervisors covering banking, insurance and securities – enable supervisors to apply EU legislation to achieve similar, and increasingly convergent, outcomes, while respecting different national legal systems and supervisory approaches, for example the UK's more principle and risk based system. The existing cooperation is good. The Level 3 committees are also already turning towards how to address efficiency gains for firms, and supervisors and will increasingly reach understandings on more common rules to apply to firms through guidelines and recommendations.

²² The FSA Chairman is leading a project team to take forward this work. Initial recommendations will be shared with the FSF in September.

²³ The Committee of European Banking Supervisors (CEBS), the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), and the Committee of European Securities Regulators (CESR).

Box 3.1: Supervisory colleges

Close cooperation between national supervisors is critical in the effective supervision of a cross-border financial group. To this end, in the EU, ECOFIN has supported the establishment of supervisory colleges, to ensure that relevant information is shared between supervisors, and that they are able to discuss issues related to the group and its impact locally.

The Authorities strongly support supervisory colleges, and believe they have the potential to bring clear benefits for the prudential supervision of groups, including:

- by being tailored to the individual firm, the college directly meets the supervisory challenges posed by the firm;
- the involvement of all those authorities within whose jurisdiction the firm has a significant presence. This particularly benefits supervisors, which gain greater information on the group and an enhanced role in its oversight;
- providing a structured framework for information collection and exchange, the establishment of regulatory programmes and the delegation of supervisory tasks; and
- increasing the efficiency of supervision by removing duplication, thereby reducing costs for firms and supervisors.

Overall, such arrangements allow a better understanding of the activities and financial soundness of the firm, improve risk mitigation, and aid supervisory cooperation and effectiveness.

Over time, colleges will lead to more common decisions and, at a minimum, greater understanding of how supervisors carry out their duties. Through colleges, supervisors increasingly reach common agreement on how to best address the supervisory challenges faced in different parts of the group. Colleges will promote innovative supervisory responses to regulatory risks. Given that the industry is constantly evolving and dynamic, the college arrangement is best suited to respond accordingly.

The Authorities strongly support greater cooperation between supervisors, within the EU and on a global basis, both to reflect the nature of the business of global groups and the risks to stability that arise from them. The EU's supervisory arrangements can act as a model for wider use in other global centres of financial services: in particular because they respect national diversity and ensure accountability remains with national authorities, while allowing for the pooling of information to benefit effective supervision and reduce costs for business.

EU cross-border supervisory arrangements

3.4 While the guidelines produced by Level 3 Committees are, and should remain, non-binding on national supervisors in the EU, they are “persuasive”. Alongside this, recent changes now provide for the option of taking a majority view if consensus on regulatory issues cannot be achieved. Taken together, these will provide for greater acceptance of common standards to be applied nationally, with supervisors having the option to explain if they choose to take a different approach. The result will be natural convergence within the EU, benefiting firms with lower costs and enhanced supervision. This will also provide for greater commonality between supervisors, ensuring supervisors better understand each other and the position of the groups they are supervising, as common rules, ideas, and reporting are being applied. Greater understanding will in turn reduce the risks of supervisors missing issues of concern and aid stability.

3.5 The Authorities strongly support ECOFIN's decision to retain and enhance the Lamfalussy arrangements, which are the most appropriate and effective means of

regulating and supervising the EU's markets, yielding increased supervisory convergence and greater efficiency gains for firms. The Authorities believe that alternative proposals, for example creating a cross-border single supervisory authority within the EU, or EU agencies, would undermine the flexibility needed for – and therefore the effectiveness of – the supervision of firms in the EU.

Box 3.2: Implications of foreign ownership of financial institutions on financial stability

The UK, as a global financial centre, has a large number of foreign-owned banks operating in its markets, including banks that take retail deposits. The UK believes that the enhancements being proposed in this paper illustrate that ownership in itself is not a primary issue, as the need for more effective supervision, and for crisis management and resolution applies regardless of ownership.

The greater use of colleges within the EU ensures that host regulators with significant operations in their jurisdiction are able to provide information to home regulators and receive relevant information from them in return. As such, in taking their decisions, they will be better informed about a group's activities and risks and on-going supervision should be more effective, reducing the risk of a crisis.

The creation of cross-border stability groups will further enhance the confidence of national authorities that any crisis can be better managed and resolved. By establishing Memoranda of Understanding, and using information from colleges, more informed decisions would be able to be taken quickly by the authorities, minimising the negative effects.

EFFECTIVE LIQUIDITY ARRANGEMENTS

3.6 Central banks are important providers of market liquidity to the banking system. The Committee on the Global Financial System (CGFS) has published a report on the provision of liquidity by central banks during the market turmoil²⁴.

3.7 Central banks can also provide emergency liquidity assistance (also known as the role of the “lender-of-last resort”) to a solvent-but-illiquid bank or other credit institution. This is a standard tool that central banks can decide to use in some circumstances for tackling the risks presented by such institutions to financial stability.

3.8 Liquidity assistance for cross-border banks will generally require coordination between several central banks. **The UK therefore supports greater cooperation between national central banks – and other relevant authorities, perhaps within Cross-Border Stability Groups (CBSGs) – to put in place practical arrangements which support and facilitate such assistance, where it is judged necessary to maintain financial stability.**

Disclosure 3.9 Given the cross-border nature of financial markets – especially those for tradeable securities issued by banks – and the increasingly international nature of the regulations covering these markets, **the UK believes that there is a case for studying more closely the arrangements for disclosure of the use of liquidity arrangements internationally, to ensure that it can be kept covert on a temporary basis in certain circumstances.** The Authorities have set out their views on this in the context of the

²⁴ Available at <https://www.bis.org/publ/cgfs31.pdf?noframes=1>

EU²⁵ but also believe that it raises issues more widely for other markets, especially given the practice of EU banks raising capital on markets elsewhere.

3.10 At the same time, while it may not be appropriate to disclose information about liquidity provision to individual institutions, **central banks should be transparent in explaining the overall framework for their liquidity provision.**

CROSS-BORDER FINANCIAL INFRASTRUCTURE

3.11 Increasingly, financial markets, firms and the wider economy rely on financial infrastructure – payment, clearing and settlement systems and other systems – that is cross-border in nature. The UK believes that effective oversight of this critical infrastructure, including the associated legal arrangements, is vital, and that it must be robust to the failure of its members or participating firms. In particular:

- robust payment, clearing and settlement systems, given that the interdependencies between such systems and their growing scale increase their importance. **The UK welcomes the work of the Committee on Payment and Settlement Systems (CPSS) and the EU to strengthen their oversight. Colleges have already proved a useful tool and will remain essential for the effective oversight of international infrastructure;**
- introduction of modern infrastructure to clear and settle recently developed markets, such as those for credit derivatives. The Federal Reserve Bank of New York and a group of supervisors, including the FSA, have been working over recent years with dealer firms on over-the-counter (OTC) credit and equity derivative issues, and in June 2008 market participants and regulators agreed a series of steps to further improve the OTC derivatives market infrastructure. The CRMPG III report²⁶ also includes a series of recommendations aimed at enhancing the resilience of credit markets, with particular attention to strengthening the safeguards associated with the OTC derivatives markets; and
- legal arrangements that ensure clarity regarding the applicable law for cross-border business and sufficient protection for participants in overseas markets. **The UK welcomes the ongoing work at both the EU and international level to strengthen the legal framework for the securities markets, such as the Legal Certainty Group, and encourages countries to adopt the Hague Convention.**

²⁵ Bank of England, HM Treasury, Financial Service Authority (July 2008). *Financial stability and depositor protection: further consultation* (Paragraph 3.36)

²⁶ Counterparty Risk Management Policy Group III (2008). *Containing Systemic Risk: The Road to Reform*

4

REDUCING THE IMPACT OF A FAILING BANK

Risks from bank failure 4.1 As witnessed over recent months, and seen in previous banking crises around the world, the failure of a bank can have significant consequences. Without having special arrangements in place, there is a risk that:

- depositors, as well as suffering a loss of wealth, might be deprived of access to their accounts at very short notice; and
- there is contagion to other banks – directly, through their exposure to one another, or indirectly, through damage to public or market confidence in the financial system.

Special tools needed at national level 4.2 Although it is right that there should be considerable focus on the steps to avoid a bank ever reaching this situation, it is clear that there will always remain a risk that banks will fail and – given the potential problems set out above – it is important to ensure that there are appropriate legal and other arrangements in place to deal with such circumstances. In the absence of such arrangements in the UK, the Authorities have proposed to introduce a “special resolution regime” to provide the relevant tools to deal with the situation and have published detailed proposed legislative clauses²⁷.

4.3 The responsibility for such arrangements falls on national authorities to reflect national characteristics – such as the shape of the local banking market – and legal systems. The UK believes that there are two issues for international action:

- to ensure that international rules facilitate rather than hinder appropriate action by national authorities; and
- to put in place the contingency planning arrangements – in particular through cross-border stability groups – to allow for action to be taken effectively where institutions’ activities are cross-border in nature.

NATIONAL ARRANGEMENTS

4.4 As noted above, arrangements for dealing with failing banks will appropriately vary from country to country. In designing and operating these arrangements, national authorities do, however, need to recognise certain international constraints:

- the UK is a firm supporter of the EU regime for ensuring that Member States do not provide unfair financial assistance to commercial enterprises in the form of state aid. The UK accordingly does not consider that Banks should be immune from the state aid rules. However, it is important that EU rules facilitate rather than hinder the implementation of essential resolution arrangements for failing banks. As Member States’ authorities may need to act quickly to ensure that financial stability and the wider public interest is protected, in the event of a failing bank, potentially with the use of public funds, **the UK will continue to monitor the appropriateness of the relevant rules and guidelines for state aid with respect to financial stability;**
- effective competition policy remains a vital part of a successful single market. The UK fully supports the application of competition policy to the

²⁷ Bank of England, HM Treasury, Financial Service Authority. (July 2008) *Financial stability and depositor protection: special resolution regime*

banking and wider financial sector in the EU and elsewhere. However, it is also clear that the application of these rules needs to be consistent with the implementation of rapid private sector solutions to financial crisis – solutions which can deliver the lowest cost outcome for the market and the best outcome for consumers. Therefore, **the UK stresses the need to ensure that decisions on competition policy can be quickly exercised to ensure there are no unnecessary barriers to speedy mergers and acquisitions in the banking sector to deliver private sector solutions to financial crisis; and**

- Article 101 of the EC Treaty prohibits in general the use of central bank resources to support government spending. However, this does not mean that central banks do not have the flexibility to use appropriate tools to deal with resolution and it is important that they continue to do so. It is, for example, entirely appropriate for central banks (and one of their functions) to be able to provide emergency facilities in times of market stress to ensure that markets can function smoothly, and to implement appropriate resolution arrangements for failing banks.

CROSS-BORDER STABILITY GROUPS

4.5 It is important that effective crisis management arrangements are in place to ensure that cross-border problems can be managed swiftly and appropriately to avert contagion. As set out in the EU’s Memorandum of Understanding on cross-border financial stability²⁸, Member States have agreed in principle to consider the formation of cross-border stability groups (CBSGs), by central banks, finance ministries and supervisors with common financial stability concerns.

Role of cross-border stability groups

4.6 To be most effective, CBSGs need to be small, focused groups, that work ex-ante to make the necessary practical preparations for the management of a crisis affecting one or more specific cross-border financial firms. Sitting alongside supervisory colleges, their aim is to identify and remove specific practical and operational obstacles to effective cross-border crisis management. Supervisory colleges, which are likely to have a wider membership and whose role is to focus on the more day-to-day supervisory issues, complement CBSGs by bringing relevant information to the group. In particular, the UK believes CBSGs should help to:

- identify and remove practical and operational obstacles to effective cross-border crisis management;
- facilitate information sharing on firm specific issues;
- develop and maintain a “common vocabulary” between countries around the EU systemic impact assessment; and
- build personal familiarity between individuals within authorities, which would ease communication during a crisis.

4.7 In line with the ECOFIN Council conclusions from its meeting on 14 May the UK believes it is crucial that central banks, supervisors and finance ministries participate in cross-border financial stability and crisis management, including through CBSGs, given that each authority has separate but vital roles in a crisis.

²⁸ Memorandum of Understanding on Cooperation between the Financial Supervisory Authorities, Central Banks and Finance Ministries of the Europe Union on Cross-Border Financial Stability. (2008)

4.8 Earlier this year, EU Member States met to discuss the development of a common systemic impact assessment framework known as the “heatmap”, which aims to create a common vocabulary to be used in a crisis. Tools such as this would enable CBSGs to facilitate the sharing of cross-border information enabling relevant authorities to make informed policy decisions during a crisis.

Action internationally 4.9 To take this forward, the Authorities are working to establish CBSGs with countries with which the UK shares common financial stability interests, within and beyond the EU. **The UK strongly supports the development of such arrangements and calls on other countries to engage in stability planning and setting up CBSGs rapidly.** National authorities should also have a framework for developing a shared assessment of risks and vulnerabilities, explicitly including risks arising from cross-border issues.

4.10 In parallel the FSF has established a small working group of supervisors and central banks to address specific cross-border crisis management planning issues.

5

PROVIDING EFFECTIVE COMPENSATION ARRANGEMENTS

5.1 It is vitally important that consumers have confidence in the financial system, including the operation of deposit guarantee schemes. Events over the last year have demonstrated the lack of public and consumer awareness and understanding of deposit guarantee schemes, and the Authorities have made a number of proposals to address this in the UK²⁹. This has in turn raised questions about how best to ensure that deposit guarantee schemes can be effective in delivering the compensation to which consumers are entitled within countries and, in the case of the EEA, on a cross-border basis under the EU's Deposit Guarantee Scheme Directive (DGSD).

5.2 Ensuring that cross-border compensation arrangements give consumers confidence, and that, where necessary, they can quickly payout across borders, is of critical importance, as financial institutions increasingly operate on a cross-border basis. In particular, the Authorities believe that inconsistent deposit guarantee scheme arrangements across the EEA can have the potential to undermine consumer confidence and therefore financial stability.

5.3 The UK therefore welcomes the European Commission's intention to examine modifications to the DGSD. In particular, the UK agrees with the European Commission's intention to increase the speed of cross-border payout, and to increase harmonisation of some of the technical measures in the Directive such as co-insurance. The UK agrees that that these two issues are very important in the cross-border context.

Proposals for consideration

5.4 In considering reforms to the Directive to strengthen the cross-border operation of deposit guarantee schemes in the EEA, and to enhance consumer confidence in retail financial services, the UK proposes the following:

- increasing the cross-border speed of payout, by amending the DGSD to reduce the current payout deadlines;
- requiring Memoranda of Understanding between relevant national deposit guarantee schemes when a bank operates on a branch basis in the EEA; and
- putting in place, as a regulatory measure, agreements between Member States to require host state deposit guarantee schemes to act as single points of contact for depositors in those Member States.

5.5 While the UK understands that it is the Commission's intention to improve cross-border payout efficiency, it is not convinced that the EEA can, or should, consider moving towards harmonised EU coverage levels. The wide disparities within the EEA of current coverage levels indicate that no one level would be appropriate. **Instead, the UK believes that alternative ways of delivering the necessary consumer confidence and protection, which may be more realistic to deliver, need to be considered, including:**

- ensuring that all consumers within any single Member State are covered to the same level. This could, for example, be achieved either by amending the DGSD (or if not by coordinated action) to require all branches to join the host state deposit guarantee scheme, or requiring that home state deposit

²⁹ Bank of England, HM Treasury, Financial Service Authority (July 2008). *Financial stability and depositor protection: further consultation* (Chapter 5)

guarantee schemes cover customers of branches in other Member States to the same level as the host country scheme; and

- **improving consumer understanding and facilitating cross-border payment arrangements** in the case of cross-border failures, by amending the DGSD to increase harmonisation of certain technical provisions among deposit guarantee schemes.

6

IMPROVING COORDINATION

6.1 A common theme running throughout this document has been the need for more effective cross-border cooperation between countries to strengthen the global financial system and protect depositors. This includes:

- continuing to support and fully engage with the various workstreams at European and global levels;
- ensuring that domestic arrangements and rules support effective cross-border cooperation and financial crisis management;
- facilitating increased cooperation and coordination among relevant countries in relation to specific institutions;
- ensuring practical and operational barriers to effective cooperation are reduced; and
- increasing transparency and improving cross-border cooperation between deposit guarantee schemes.

National coordination

6.2 Underpinning cross-border cooperation is the assumption that national authorities work well together within a country. To ensure that is the case, the UK believe that it is important to establish roles between authorities and effectively communicate those to the financial service sectors and consumers. In the UK a Memorandum of Understanding exists between HM Treasury, the Bank of England and the FSA, which defines the role of each authority and provides a framework within which to operate. The Authorities are currently revising this MOU in the light of expansion and its proposed new tools.

6.3 The UK proposes that countries worldwide examine their national arrangements to ensure that their authorities are able to cooperate with each other domestically and internationally, including through colleges and CBSGs.

Crisis tests

6.4 Finally, a key part of strengthening cross-border cooperation is to ensure that the crisis management tools and plans in place are as robust as possible. Crisis simulation exercises are a useful means for identifying further barriers, which may delay effective resolution and contagion in a crisis. The next EU-wide exercise is scheduled for May 2009, with a trial run scheduled in March. The outcomes of the exercise will no doubt highlight areas – and rightly so – which require further developments. **The UK propose that crisis testing needs to be carried out at the international, as well as regional, level given the global nature of financial institutions and markets today, and call on countries to extend their testing appropriately.**

SUMMARY

6.5 In parallel to the actions being taken within the UK, this document has set out the following proposals:

1. In relation to strengthening the stability and resilience of the financial system:
 - the UK encourages market participants to continue to work together in learning the lessons from the ongoing financial markets disruption and in implementing appropriate solutions;

- the UK will throughout 2009 ensure that G20 members are involved and engaged in discussions about the stability and resilience of the financial system;
 - the UK will support the evolution of the FSF's outreach programme, building on models such as the Basel Committee's International Liaison group, to deepen engagement;
 - the UK will encourage wider inclusion of emerging markets within the financial stability work programmes of the FSF and IMF; and
 - the UK continues to support the idea of an Early Warning System based on analysis from the FSF enhanced by the macroeconomic surveillance of the IMF, to identify international risks to financial stability.
2. In relation to reducing the likelihood of banks facing difficulties:
- the UK supports the establishment of supervisory colleges for all significant cross-border firms to reinforce and improve supervisory cooperation, and the prioritisation of this work of other relevant authorities;
 - the UK supports steps by EU Member States to focus on implementing the positive changes in the supervision roadmap, as requested by ECOFIN in May 2008;
 - the UK proposes that countries globally review their supervisory arrangements, to ensure that there are no barriers to their national supervisors cooperating with those in other countries and being able to have regard to the stability of global markets. In the EU Member States have made a political commitment to ensure national supervisory mandates enable this. The FSA will continue to have regard to both the EU and global dimension when carrying out its role;
 - the UK supports greater cooperation between national central banks – and other relevant authorities, perhaps within Cross-Border Stability Groups – to put in place practical arrangements which support and facilitate liquidity assistance, where it is judged necessary to maintain financial stability;
 - the UK believes that there is a case for studying more closely the arrangements for disclosure of the use of liquidity arrangements internationally, to ensure that it can be kept covert on a temporary basis in certain circumstances;
 - the UK believes central banks should be transparent in explaining the overall framework for their liquidity provision;
 - the UK welcomes the work of the Committee on Payment and Settlement Systems (CPSS) and the EU to strengthen their oversight. Colleges have already proved a useful tool and will remain essential for the effective oversight of international infrastructure; and
 - the UK welcomes the ongoing work at both the EU and international level to strengthen the legal framework for the securities markets, such as the Legal Certainty Group, and encourages countries to adopt the Hague Convention.
3. In relation to reducing the impact of a bank failing:

- the UK is a firm supporter of the EU regime for ensuring that Member States do not provide unfair financial assistance to commercial enterprises in the form of state aid. The UK accordingly does not consider that Banks should be immune from the state aid rules. However, it is important that EU rules facilitate rather than hinder the implementation of essential resolution arrangements for failing banks. As Member States' authorities may need to act quickly to ensure that financial stability and the wider public interest is protected, in the event of a failing bank, potentially with the use of public funds, the UK will continue to monitor the appropriateness of the relevant rules and guidelines for state aid with respect to financial stability;
 - the UK stresses the need to ensure that decisions on competition policy can be quickly exercised to ensure there are no unnecessary barriers to speedy mergers and acquisitions in the banking sector to deliver private sector solutions; and
 - the UK strongly supports the development of CBSGs with countries with which the UK shares common financial stability interests, within and beyond the EU and calls on other countries to engage in stability planning and setting up CBSGs.
4. In relation to providing effective compensation arrangements:
- the UK welcomes the European Commission's intention to examine modifications to the DGSD;
 - the UK proposes increasing the cross-border speed of payout, by amending the DGSD to reduce the current payout deadlines;
 - the UK proposes requiring Memoranda of Understanding between relevant national deposit guarantee schemes when a bank operates on a branch basis in the EEA;
 - the UK proposes putting in place, as a regulatory measure, agreements between Member States to require host state deposit guarantee schemes to act as single points of contact for depositors in those Member States;
 - the UK proposes consideration of how to ensure that all consumers within any single Member State are covered to the same depositor protection level. This could, for example, be achieved either by amending the DGSD (or if not by coordinated action) to require all branches to join the host state deposit guarantee scheme, or requiring that home state deposit guarantee schemes cover customers of branches in other Member States to the same level as the host country scheme; and
 - the UK proposes improving consumer understanding and facilitating cross-border payment arrangements in the case of cross-border failures, by amending the DGSD to increase harmonisation of certain technical provisions among deposit guarantee schemes.
5. In relation to improving coordination:
- the UK proposes that countries worldwide examine their national arrangements to ensure that their authorities are able to cooperate with each other domestically and internationally, including through colleges and CBSGs; and

- the UK proposes that crisis testing needs to be carried out at the international, as well as regional, level given the global nature of financial institutions and markets today, and calls on countries to extend their testing appropriately.

ISBN 978-1-84532-418-6



9 781845 324186