

**Overview of Progress in the Implementation of
the G20 Recommendations
for Strengthening Financial Stability**

Report of the Financial Stability Board to G20 Leaders

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Since the Pittsburgh Summit, the Financial Stability Board (FSB) and its members have continued to press ahead with the G20 program of financial reforms. As called for by the G20 Leaders in Pittsburgh, the FSB has continued to coordinate and monitor progress, “which will be essential to the full and consistent implementation of needed reforms”. We reported on progress to the G20 Finance Ministers and Central Bank Governors at their meetings in St Andrews, Washington DC, and most recently in Busan.

This note focuses on international and national policy development on the fundamental elements of the global reform agreed at Pittsburgh:

- Strengthening bank capital and liquidity standards;
- Addressing systemically important financial institutions and resolutions;
- Improving OTC derivatives markets and core financial market infrastructures;
- Reforming compensation practices to support financial stability;
- Strengthening adherence to international supervisory and regulatory standards.

Policy work in these areas is progressing to agreed, or accelerated, timelines. 2010 and 2011 will be critical years for these core areas of global reform, in which momentum needs to be maintained to finalise and implement the reforms to achieve the long run objectives of a more resilient global system.

This report describes the measures that have been taken and other progress made in these and other areas. The FSB will next report on progress to the G20 at their meetings in Korea in the fall of 2010.

I. Building high quality capital and liquidity standards and mitigating procyclicality

Progress on key reforms to strengthen bank capital and liquidity standards remains a top priority, and the timelines have been accelerated. As highlighted in the accompanying note for the Summit, the Basel Committee on Banking Supervision (BCBS) will prepare calibrated proposals for the new regulatory framework by the November Summit in Seoul. The main aims of the reforms are:

- Raise the quantity, quality, consistency and transparency of the capital base;
- Strengthen the risk coverage of the capital framework;
- Introduce a leverage ratio as a supplementary measure to the risk-based requirements, with a view to migrating to a Pillar 1 treatment subject to appropriate review and calibration;

- Address procyclicality by promoting the build-up of capital buffers in good times, that can be drawn down in periods of stress, as well as through more forward-looking provisioning based on expected losses; and
- Introduce a global minimum liquidity standard.

Public consultation on the proposals released in December 2009 ended in April 2010. The BCBS is conducting a detailed quantitative impact study of the proposals, as well as a “top-down” assessment to inform the overall calibration of the new standards. A separate assessment of the macroeconomic impact of the reforms is being carried out jointly by the BCBS and the FSB, to guide decisions on transition. This exercise has comprised central banks and regulators in fifteen countries using and a number of international institutions and has used a wide range of models and approaches to ensure robust results. Close collaboration with the IMF has been an essential part of the process.

Good progress has been made in recent weeks to revise the proposals in the light of the impact studies and the feedback from the public consultation. The focus now is on the calibration of new standards that will provide the robustness needed for a more sustainable banking system in the long-term, and on the design of appropriate transition arrangements, based on the macroeconomic impact assessment, to ensure that implementation does not impede the economic recovery.

II. Addressing systemically important financial institutions and resolutions

The FSB will develop by the end of October 2010 a policy framework of concrete recommendations for measures to address the moral hazard risks associated with systemically important financial institutions (SIFIs). The work has proceeded on three fronts: (i) reducing the probability and impact of failure; (ii) improving the capacity to resolve firms in crisis; and (iii) reducing interconnectedness and contagion risks by strengthening the core financial infrastructures and markets. Work is underway to integrate the policy recommendations emerging from these workstreams into a comprehensive and consistent framework. The proposed framework would call for jurisdictions with SIFIs to put in place policies that enable supervisory and regulatory actions to reduce the moral hazard associated with these firms. An interim report on this project is being submitted to the Toronto Summit; final recommendations will be submitted to the G20 November Summit.

Reducing the probability and impact of failure

The proposals issued by the BCBS (see Section I above) will have a positive impact in reducing risks at SIFIs. But these measures are primarily aimed at ensuring that all banks have sufficient capital to meet the risks arising from their own exposures, and not at protecting the system from the wider externalities that SIFIs create. For this reason, we are assessing a broad spectrum of potential reforms that are more specifically focused on SIFIs. These include additional prudential requirements, such as capital and/or liquidity surcharges; use of contingent capital; as well as debating the merits of steps to limit the size and breadth of institutions.

Measures are also being considered to enhance the intensity and effectiveness of SIFI supervision. The FSB is reviewing which supervisory approaches proved most effective in

light of the crisis, and in which areas it is critically important to strengthen arrangements. At present, not all supervisors have adequate mandates, independence and resources to intensively oversee banks' activities. In some cases, supervisors lack authority to require banks to take additional action to address weaknesses, including potentially through holding further capital above the minimum level. Authorities need such additional powers as an essential component of defences against financial institution mismanagement and failure. This will require amending legislation in some countries. The FSB will set forth the action needed in these and other areas.

In order to promote enhancements to supervision, combined with stronger risk management, and to improve resolvability in the insurance sector, the International Association of Insurance Supervisors (IAIS) is developing group-wide supervisory standards for all insurance groups and a *Common Framework for the Supervision of Internationally Active Insurance Groups* (ComFrame).

Improving the capacity to resolve firms in crisis

In Pittsburgh, the G20 Leaders called for developing resolution tools and frameworks for the effective resolution of financial groups to help mitigate the disruption of financial institution failures and reduce moral hazard. Indeed, any effective approach to addressing the TBTF problem needs to have effective resolution at its base. Progress is being made to improve the capacity to undertake an orderly resolution and to improve ex ante preparedness, contingency planning, cooperation and information exchange among the relevant authorities. Work is also underway looking at how to introduce effective measures into the resolution toolkit which allow authorities to haircut unsecured creditors. Orderly resolution should involve shareholders and some debt holders absorbing losses, and ensure continuity of critical financial functions.

In March 2010, the BCBS issued its final *Report and Recommendations of the Cross-border Bank Resolution Group*, setting out recommendations falling into three categories: strengthening national resolution powers and their cross-border implementation, firm-specific contingency planning, and reducing contagion. The FSB will develop by October 2010 common principles that will help to achieve greater consistency among national resolution frameworks and to improve coordination of resolution measures across borders. It will set out the key attributes that effective national resolution regimes should have, including a menu of resolution tools that authorities should have at their disposal and can choose from. The FSB will also be setting out principles for cross-border resolutions. To enable cross-border resolution, changes to national resolution and insolvency processes and laws could be required. In parallel, the International Monetary Fund (IMF) plans to lay out later this year proposals for the design of an international framework for enhanced coordination on the resolution of cross-border banks, including the elements of countries' operational and legal frameworks that would need to be in place to establish such a network.

Effective resolution is a function not only of national regimes and their capacity to coordinate and cooperate across borders, but also of the nature of firms themselves and their activities and structures. The cross-border crisis management groups that have been established for the major international financial firms are developing recovery and resolution plans that could be used under existing national frameworks. The FSB will use this as an input to set out key factors that affect an institution's resolvability.

Strengthening the core financial infrastructures and markets

The interconnectedness of SIFIs with other market participants, especially other systemically relevant firms, has been a significant factor driving public intervention to prevent failure of SIFIs. Work is underway to reduce contagion risk through improvements to the robustness of core financial market infrastructures that tie SIFIs together (see Section III).

An overall SIFI policy framework

In the work to integrate the contributions of the workstreams in a comprehensive and consistent framework, some key principles have been developed as the basis for concrete policy recommendations. We need to ensure that all jurisdictions with SIFIs have strong policies in place, and that these are sufficiently coordinated to achieve a level playing field and avoid regulatory arbitrage. While we agree on the need for a common floor to standards, our discussions to date indicate that some national discretion might be needed to allow authorities to tailor regulatory and supervisory actions to domestic conditions. The FSB will put in place a peer review mechanism to check that national policies to address the risks associated with SIFIs are consistent and mutually supportive, and thus effective in achieving global risk reduction.

III. Improving over-the-counter derivatives markets

G20 Leaders agreed in Pittsburgh that all standardised over-the-counter (OTC) derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties (CCPs) by end-2012. They also agreed that OTC derivative contracts should be reported to trade repositories. Progress is being made toward achieving these objectives. Work is proceeding through initiatives in international bodies, legislative and administrative processes in major jurisdictions, and continuing industry efforts. Consistent implementation at a global level is crucial so as to avoid the regulatory arbitrage that would otherwise undermine the initiative.

In April 2010, at the initiative of the FSB, a working group led by representatives of the Committee on Payment and Settlement Systems (CPSS), International Organization of Securities Commissions (IOSCO) and the European Commission (EC) was formed to identify factors that make derivatives clearable and set out policy options to support the consistency of implementation of clearing and exchange or electronic trading requirements across jurisdictions. It will report to the FSB in October 2010. It is also addressing the scope for exemptions from clearing and exchange or electronic trading requirements by non-financial end-user firms, whose business should be cleared through CCPs where it has systemic importance.

Strong standards for CCPs are essential if they are to reduce systemic risk. In May 2010, the CPSS and IOSCO published for comment guidance in applying their existing standards for CCPs so as to better address risks associated with clearing OTC derivatives. CPSS and IOSCO have also published for comment policy guidance for the establishment of trade repositories in OTC derivatives markets. In addition, the two bodies are reviewing their joint core standards for financial market infrastructure. A consultative report will be published by early 2011. In addition, the OTC Derivatives Regulators' Forum, comprised of central banks, supervisors and market regulators with direct authority over derivatives market infrastructure

or participants, has launched workstreams to develop international cooperative oversight arrangements and consistent standards for information sharing by CCPs and repositories with authorities and the public.

One reason for mandatory trade reporting of OTC derivatives transactions, whether centrally cleared or bilaterally settled, is to enable authorities to assess the build-up of potential systemic risk. There is agreement that central banks, supervisors, and regulators globally should have access to the data from CCPs and repositories to support them in carrying out their respective mandates. One area in which views differ between authorities is on the merits of global versus local CCPs and trade repositories. Some authorities stress the benefit of additional netting of risk in a global CCP while others are concerned about concentration of risk or local access to international infrastructure.

In order to meet the deadline agreed by G20 Leaders, legislative actions may need to be developed while this international work is taking place. Indeed, these actions have reached an advanced stage in some major jurisdictions, and legislation may be passed before the international recommendations are agreed. It is important therefore that national and regional legislation takes into account the need to reach the necessary international consistency that will enable regulatory arbitrage to be avoided.

IV. Strengthening accounting standards

At the Pittsburgh Summit, the G20 Leaders called on international accounting bodies to redouble their efforts to achieve a single set of high quality, global accounting standards within the context of their independent standard setting process, and to complete their convergence project by June 2011. They also recommended that the International Accounting Standards Board's (IASB) institutional framework further increase stakeholder involvement. In addition, at the London Summit the G20 Leaders welcomed the Financial Stability Forum (FSF)'s procyclicality recommendations relating to accounting and called on "accounting standard setters to work urgently with supervisors and regulators to improve standards on valuation and provisioning."

Nearly all FSB member jurisdictions have either adopted IASB standards or have programmes underway to converge with or consider adoption of the standards of IASB by 2012. The IASB has maintained an extensive programme to further improve the involvement of various stakeholders.

In June, the IASB and US Financial Accounting Standards Board (FASB) jointly announced that the Boards have developed a modified strategy that retains the target completion date of June 2011 for most convergence projects but the target completion dates for a few other projects have extended into the second half of 2011. The changes in the specific project target deadlines will be published soon by the Boards. The Boards decided to delay certain project deadlines because stakeholders voiced concerns about their ability to provide high-quality input on the large number of planned major Exposure Drafts (EDs). The US Securities and Exchange Commission (SEC) Chairman issued a statement that indicated that this action should not impact the SEC's determination in 2011 whether to incorporate IASB standards into the financial reporting system for US issuers.

We see progress toward FSB recommendations for improved, converged accounting standards in four areas.

1. *Impairment of financial assets:* The FSB recommended that the IASB and FASB incorporate a broader range of available credit information than existing provisioning requirements, so as to improve transparency of information provided to investors while also potentially helping lessen procyclicality. Both the IASB and FASB have proposed alternative loss provisioning approaches that incorporate more information about credit losses into impairment measurements and provide for earlier assessment of expected losses. The proposals have significant differences from each other and the Boards are seeking to converge their provisioning approaches with input from investors, banks, auditors, and regulators, including an Expert Advisory Panel..
2. *Derecognition:* The FSB had also expressed concern that the IASB's proposal on derecognition, which has been subject to consultation, would require repurchase agreements to be treated as sales and forward contracts in certain situations (thus leading to off-balance sheet treatment), instead of as financing transactions on the balance sheet as under current IASB standards. The IASB has revised its plans and the on-balance sheet treatment of repos will be reinforced by the IASB when finalising its derecognition standard.
3. *Addressing valuation uncertainty in fair value measurement guidance:* Upcoming further enhancements to IASB and FASB fair value measurement standards this year will align requirements about how to measure fair value when markets become less active and address valuation adjustments for valuation uncertainty.
4. *Netting/offsetting of financial instruments:* In reporting to the Pittsburgh Summit, the FSB expressed concern that the differences between the IASB and FASB approaches to the netting/offsetting of financial assets and liabilities can result in significant differences in the total assets of large financial institutions, with implications for BCBS work to frame an international leverage ratio. In response to stakeholders' concerns, including those of the FSB and BCBS, the Boards have decided to issue an ED proposing changes to address differences in their standards on balance sheet netting of derivative contracts and other financial instruments.

In recommending to the Pittsburgh Summit that the IASB and FASB develop improved converged standards that would simplify and improve the accounting principles for financial instruments and their valuation, the FSB noted that it was particularly supportive of standards that would not expand the use of fair value in relation to the lending activities (involving loans and investments in debt instruments) of financial intermediaries. The IASB issued IFRS 9 in November 2009 which includes an amortised cost category for financial assets such as loans and certain investments in debt securities.

However, while IASB efforts have been broadly consistent with this recommendation, the FASB proposal in May 2010 sets forth an approach using fair value measurement on the balance sheet and through "other comprehensive income" for loans and investments in debt securities. Under this proposal, changes in fair values of lending instruments would affect reported shareholders' equity, but would not be included in profit and loss. In the FASB ED, the FASB is asking for feedback from interested parties on their approach and on Board members' alternative views discussed in the ED, including alternative views on fair value

measurement for loans. Thus, there is the potential that the two standard setters may reach different conclusions on the accounting for lending activities in their final standards. We hope that the accelerated dialogue between the Boards announced by the IASB and FASB Chairmen, including the Boards' consideration of the comments of stakeholders, will result in improved and converged approaches in their final standards as recommended in the FSB report.

V. Strengthening adherence to international supervisory and regulatory standards

Building on the FSB Charter endorsed by G20 Leaders at the Pittsburgh Summit, the FSB put in place in January 2010 a *Framework for Strengthening Adherence to International Standards* (http://www.financialstabilityboard.org/publications/r_100109a.pdf). Under the framework, FSB member jurisdictions commit to lead by example by implementing international financial standards, undergoing an assessment under the IMF-World Bank Financial Sector Assessment Program (FSAP) every five years, participating in thematic and country peer reviews of FSB members, and publishing the results of these assessments. Thematic peer reviews focus on the implementation across the FSB membership of specific standards or policies agreed within the FSB, while country peer reviews focus on implementation in a specific member jurisdiction.

The FSB completed its first thematic peer review, on compensation, in March 2010 (see section VI). Two further thematic reviews will be completed by end-2010. One will examine risk disclosures by major financial institutions. It will follow up on the implementation of the recommendations regarding risk disclosures contained in the April 2008 Report of the FSF on *Enhancing Market and Institutional Resilience*. The other will survey existing practices in mortgage origination, so as to follow up on recommendations in the January 2010 Joint Forum report on the *Differentiated Nature and Scope of Financial Regulation*.

Country peer reviews follow up mainly on recommendations relating to financial regulation or supervision arising from a recent IMF-World Bank FSAP of the country. Based on the schedule of recently completed FSAPs, Italy, Mexico and Spain will each undergo a country review in 2010. The review of Mexico is well advanced and is expected to be completed in July 2010.

The IMF and World Bank are undertaking a regular review of the standards and codes initiative including the list of the 12 key standards, and assessing their continuing relevance given the lessons of the recent financial crisis. The work is being coordinated with a similar review by the FSB.

Responding to the call by the G20 Leaders to promote global compliance with international standards, the FSB launched in March 2010 an initiative to encourage improved adherence to international cooperation and information exchange standards in the financial regulatory and supervisory area (http://www.financialstabilityboard.org/publications/r_100310.pdf). All 24 FSB member jurisdictions, as well as other jurisdictions that rank highly in financial importance globally, are having their adherence to these standards evaluated under this initiative.

Jurisdictions for which there is not at present sufficient evidence of strong adherence to the relevant cooperation and information exchange standards have been invited to engage in a

confidential dialogue with the FSB to address information gaps, further evaluate areas of weakness and identify an action plan to improve compliance. Many countries have taken actions this year to provide additional evidence of their adherence to standards, including by requesting new assessments of compliance by the IMF and World Bank and becoming signatories to the IOSCO *Multilateral Memorandum of Understanding concerning Consultation and Cooperation and the Exchange of Information* (MMoU), and as a result some are close to completing the process of dialogue.

A variety of measures have been identified that could be used to promote adherence to international standards under this initiative. The FSB will seek to use positive measures in the first instance, such as policy dialogue and technical assistance. The FSB, in cooperation with its members and other international bodies, recently completed a review of capacity building initiatives in financial regulation and supervision, which helped to identify the scope for reorienting technical assistance to meet countries' requests arising from the FSB's initiative. Negative measures are also available as appropriate to promote adherence, including the option of publishing by the end of 2010 the names of non-cooperative jurisdictions in the event that other measures are not achieving sufficient progress.

The FSB's initiative on cooperation and information exchange complements the work of other international bodies, such as IOSCO, which achieved in January 2010 its goal, set in 2005, of having its eligible membership sign or commit to sign the MMoU. The MMoU provides a mechanism for securities regulators to share with each other essential investigative material, such as beneficial ownership information, as well as securities and derivatives transaction records, including bank and brokerage records. It sets out specific requirements for the exchange of information, thereby ensuring that banking secrecy and other laws or regulations do not prevent the sharing of securities enforcement information among securities regulators. The IAIS is also expanding the coverage of its MMoU to facilitate cross-border communication among insurance supervisors.

VI. Reforming compensation practices to support financial stability

The FSB launched in December 2009 a review of the steps taken or planned by FSB member jurisdictions to implement the *FSF Principles for Sound Compensation Practices and their Implementation Standards*. The review also covered progress to date in implementation by significant financial institutions. The review was concluded and published in March 2010, according to the timeline set by the G20 Leaders at Pittsburgh¹.

The review concludes that considerable progress has been made across the board regarding the implementation of the FSB Principles and Standards, including significant changes in regulatory and supervisory frameworks across the FSB membership. At the same time, the review recognises that more work needs to be done to ensure that the Principles and Standards are fully implemented by the end of 2010. It recommends additional measures in areas necessary to support the emergence of sound practice and further convergence, including enhanced supervisory cooperation on compensation with regard to cross-border firms, especially across the major financial centres; support in the development of sound industry

¹ The compensation review is available at http://www.financialstabilityboard.org/press/pr_100330a.pdf.

practices, notably in the area of risk-adjustment of compensation (both ex-ante adjustments of bonus pools and ex-post deferral and malus mechanisms); and increased coverage of significant nonbank financial institutions.

International policy work continues to respond to these recommendations. In particular, work by the BCBS to develop by end-October 2010 a consultative report on the range of methodologies for risk and performance alignment of compensation schemes is well advanced. The BCBS has also initiated work in the area of enhanced compensation-related disclosures in Pillar 3 of Basel II. The IAIS released in March 2010 draft *Standards and Guidance on Remuneration* that support the consistent implementation of the FSB Principles and Standards and highlight remuneration issues that are more specific to the insurance industry.

To maintain momentum, the FSB will conduct a further and more detailed review of implementation in the second quarter of 2011.

VII. Developing macroprudential frameworks and tools

A clear lesson from the crisis is the need for much stronger focus on system-wide or macroprudential risks that threaten the safety and soundness of the financial system as a whole. An important corollary is that regulatory and supervisory tools must be developed to address and mitigate such system-wide risks.

Institutional frameworks are being amended to strengthen system-wide oversight:

- In the US, a proposal to create a Financial Services/Stability Oversight Council is contained in both the House and Senate versions of the Financial Reform Bill which are currently being reconciled in a joint conference. Stricter prudential standards will be applied to firms which are judged to be systemically important.
- A new European Systemic Risk Board (ESRB) is being created, which shall be responsible for the macroprudential oversight of the EU financial system as a whole. The ESRB will provide early warning of risks, recommend actions to address them and monitor compliance with its recommendations. European authorities to whom recommendations are addressed will need to provide information on the actions undertaken or explain why no action has been taken.
- National frameworks have been reviewed in a number of other countries and amendments have been made or planned. For example, in India a high-level Financial Stability and Development Council has been announced with responsibility for macroprudential supervision. In the United Kingdom, the government has announced plans to give the Bank of England control of macroprudential regulation. A Systemic Risk Coordination Committee has been established in Turkey.

Tools to mitigate macroprudential risks are under development on a number of fronts. Key examples include:

- The BCBS is developing proposals to introduce additional “countercyclical buffers” that are built up in good times and that can be released in downturns. As noted above, the Committee is also exploring the potential merits and design of capital and liquidity surcharges for SIFIs to lower the probability and impact of their failure.

- The Committee on the Global Financial System (CGFS) reviewed issues and experience related to the design and implementation of macroprudential policy and the use of macroprudential instruments.² The CGFS also published in March 2010 a report on the role of margin requirements and haircuts in contributing to financial system procyclicality. The report recommends policy options directed at margining practices to dampen the build-up of leverage in good times and soften the systemic impact of the subsequent deleveraging.³
- The IAIS is promoting cross-sectoral macroprudential monitoring of potential build-up of systemic risk and planning to develop measures for national authorities to assess degrees of systemic risk.⁴
- The proposals by the IASB and FASB for expected loss provisioning approaches will facilitate earlier recognition of credit losses and thus help to dampen procyclicality.
- Initiatives to strengthen core financial infrastructure will lower the risks of contagion in the event of an institution's failure. The work outlined above to improve the infrastructure for the trading and clearing of OTC derivatives markets is an essential element.

Work is also underway to improve the information base for macroprudential analysis. In November 2009, the G20 Finance Ministers and Central Bank Governors endorsed 20 recommendations to address information gaps set out in the report "*The Financial Crisis and Information Gaps*" prepared by the FSB Secretariat and IMF staff⁵. A follow-up report setting out concrete action plans and timetables to address each of the recommendations was prepared for the recent meeting of Ministers and Governors in Busan⁶.

IOSCO published in June 2010 revised *Objectives and Principles of Securities Regulation* (Principles) to incorporate eight new principles, based on the lessons learned from the recent financial crisis and subsequent changes in the regulatory environment, which are designed to strengthen the global regulatory system against future crises. The new principles recognise the need for regulators to be conscious of systemic risk and the role they play in relation to it.

VIII. Expanding the regulatory perimeter

Hedge funds

Legislation to establish registration, reporting and oversight arrangements for hedge funds/advisers is advancing in major jurisdictions, notably the EU and the US.

- The EC proposed a Directive on Alternative Investment Fund Managers in 2009 to improve macro-prudential oversight of the sector, increase transparency and strengthen

² *Macroprudential instruments and frameworks: a stocktaking of issues and experiences*. CGFS Publications no 38, May 2010.

³ <http://www.bis.org/publ/cgfs36.htm>

⁴ *IAIS position statement on key financial stability issues*, 4 June 2010.

⁵ http://www.financialstabilityboard.org/publications/r_091107e.pdf

⁶ http://www.financialstabilityboard.org/publications/r_100510.pdf

investor protection. The proposed Directive, currently under negotiation in the Council of Ministers and the European Parliament will require managers to be authorised and supervised, to report regularly to competent authorities on their major exposures and use of leverage, and to comply with a series of ongoing operational and organisational requirements. Once political agreement has been reached, the Directive will require transposition into the national legal systems of the Member States.

- Legislation passed by the US House of Representatives in December 2009 and by the US Senate in May 2010 would eliminate the “private fund investment adviser” exemption and subject nearly all advisers to private funds to registration and record-keeping requirements. Each bill would also require hedge funds advisers with assets under management above a certain threshold to register with the SEC. Fund advisers would be required to report on funds’ leverage, counterparty exposure and other such information as deemed necessary by the supervisors for the assessment of systemic risk. Both bills provide for prudential safeguards for systemically relevant hedge funds.

In February 2010, IOSCO published a template for the global collection of hedge fund information to enable the collection and exchange of consistent and comparable data among regulators and other competent authorities and facilitate international supervisory cooperation in identifying possible systemic risks posed by this sector. IOSCO is also conducting a broad review of implementation of its principles for the regulation of hedge funds adopted in June 2009 and is developing a methodology for assessing their implementation. IOSCO’s revised *Objectives and Principles of Securities Regulation* published in June 2010 include a new principle that “(r)egulation should ensure that hedge funds and/or hedge funds managers/advisers are subject to appropriate oversight.”

Credit rating agencies

At the London Summit, G20 Leaders agreed that the regulatory oversight regime of credit rating agencies (CRAs), consistent with the IOSCO *CRA Code of Conduct Fundamentals*, should be established by end-2009. Following this commitment, national and regional initiatives have been taken or are underway to strengthen oversight of CRAs:

- In the US, the SEC has adopted or proposed amendments to its rules on nationally recognised statistical rating organisations (NRSROs) in order to foster accountability, transparency, and competition in the credit rating industry as well as to address conflicts of interest at NRSROs, including through enhancements to their disclosure requirements. Legislation passed by the House of Representatives in December 2009 and by the Senate in May 2010 further strengthens oversight, increases transparency and reduces conflicts of interest at NRSROs.
- In the EU, regulation introducing oversight and supervision of CRAs entered into force in December 2009; and the Committee of European Securities Regulators will later this year issue guidance on various topics including the registration process and supervisory practices for CRAs. Within the framework of the EU supervisory and regulatory reform underway, the new European Securities and Markets Authority would be in charge of the registration and supervision of CRAs in the EU.

- In Japan, the final version of a cabinet order and cabinet office ordinances were published in December 2009, following the June 2009 Bill that introduced a new regulatory framework for CRAs. The new regulations became effective in April 2010.
- Many other G20 countries have also introduced or are on the way to introducing new regulatory oversight frameworks for CRAs.

While these national moves adopt as a starting point for regulation the IOSCO CRA *Code of Conduct Fundamentals*, attention is needed to avoid requirements coming into place in different jurisdictions that fragment rating markets or impose unnecessary burdens on CRAs. At the request of the FSB, the US, EU and Japan have been continuing their discussions to resolve any significant inconsistencies or frictions that may arise as a result of differences among their new CRA regulations. In May 2010, IOSCO issued for public consultation a report reviewing CRA supervisory initiatives in several of its member jurisdictions in order to evaluate whether, and if so how, these regulatory programs implement the IOSCO CRA Principles.

Heightened sovereign risk recently has re-focused attention on the “cliff” effects that occur when credit ratings are downgraded below key thresholds. To a degree, these cliff effects are man-made since official use of CRA ratings in prudential rules, regulations and official operations can encourage a mechanistic response to a ratings downgrade.

In response to the FSB and G20 recommendations to review the use of ratings in the regulatory and supervisory framework, some steps have been taken to reduce official sector use of ratings. The BCBS, for instance, is working to address a number of inappropriate incentives arising from the use of external ratings in the regulatory capital framework. National and regional authorities have also taken steps to lessen undue reliance on ratings in rules and regulations or are considering ways to do so.

Despite this improvement, challenges remain in this area, not least in identifying objective alternatives to CRA ratings. As guidance to assist this work, the FSB has collected information on the measures taken both at international and national levels, and is discussing the development of high-level principles for use by authorities in reducing their reliance on ratings.

Supervisory colleges

Core supervisory colleges for the more than thirty large complex financial institutions have been in operation since last year.

As part of its work on effective supervisory practices for SIFIs, the FSB is reviewing the role of supervisory colleges and how their operation can be made more effective. In May 2010 IOSCO released a set of *Principles Regarding Cross-Border Supervisory Cooperation*. These Principles, accompanied by a report and sample Memorandum of Understanding, set out how securities regulators can better build and maintain cross-border cooperative relationships that will allow them to more effectively oversee financial services providers such as investment advisers, asset managers, hedge funds, CRAs, exchanges and clearing houses that operate in multiple jurisdictions.

In March 2010 the BCBS released a consultative document on good practices on supervisory colleges. The proposed good practice principles are designed to help both home and host

supervisors to ensure that supervisory colleges work as effectively as possible by outlining expectations in relation to college objectives, governance, communication and information sharing. The IAIS adopted a supervisory guidance paper on the use of supervisory colleges in group-wide supervision in October 2009.

Securitisation

Re-establishing securitisation on a sound basis remains a priority in order to support provision of credit to the real economy and improve banks' access to funding in many jurisdictions. Numerous initiatives by regulators, central banks and the private sector to improve market practices have been undertaken with the aim of rebuilding investor confidence, but the securitisation markets remain largely moribund. Understanding whether the initiatives undertaken thus far actually met the aim of rebuilding investor confidence and if not, what additional action is needed, is critical to restoring capacity and liquidity in securitisation markets.

International efforts to improve transparency and the alignment of incentives in the area of structured finance are ongoing. As part of its December 2009 package, the BCBS, which adopted certain changes in July 2009, has proposed additional requirements strengthening capital treatment of structured products and continues to further review the treatment. In April 2010, IOSCO, which published recommendations on enhancing securitisation practices in September 2009, published disclosure principles for asset-backed securities. The Joint Forum agreed at its meeting on 15 June to begin a project to be completed by end-2010 studying the evolution of incentives, likely future direction and perceptions as to whether incentives are aligned.

National and regional measures have also been introduced to improve securitisation markets. This includes changes confirmed by the European Central Bank in April 2010 and similar changes proposed by the Bank of England in March 2010 to their collateral eligibility rules requiring greater transparency, including over loan-level data and reporting of information in a standardised format. The Bank of England has further proposed that cash-flow models be made publicly available. Similarly, the US SEC proposed rules in April 2010 that would require publishing computer programs of contractual cash-flow provisions as well as other additional asset-level disclosure and changes to the offering process. The Federal Deposit Insurance Corporation has also proposed a rule with conditions on securitisation structures in order for such transactions to receive safe harbour treatment in the event of a bank insolvency. The proposal is designed to complement the proposal put forth by the SEC. Legislative and regulatory measures in major jurisdictions have been proposed or implemented that would require originators of securitisations to retain a minimum level of ownership with the aim of better aligning incentives.

Despite the substantial efforts to improve these markets, securitisation issuance volumes remain slow to revive. The FSB continues to monitor developments in this area and consider what further actions could assist the development of more robust securitisation markets, including what could be done to encourage the return of a stable investor base.