FSB FINANCIAL STABILITY BOARD

Progress since the St Andrews meeting in Implementing the G20 Recommendations for Strengthening Financial Stability

Report of the Financial Stability Board to G20 Finance Ministers and Governors

Part 1

Policy development at the international level

Part 2

Implementation at national and regional levels

19 April 2010

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Table of Contents

Introduction……………………………………………………………………………………4

Part 1: Policy development at the international level

I. Building high quality capital and liquidity standards and mitigating procyclicality 5

II. Reforming compensation practices to support financial stability……….……………......... 6

III. Improving over-the-counter derivatives markets... 7

IV. Addressing systemically important financial institutions and cross-border resolutions 8

V. Strengthening adherence to international supervisory and regulatory standards.............. 11

VI. Strengthening accounting standards 12

VII. Other issues... 14

VII.1. Developing macroprudential policy frameworks and tools... 14

VII.2. Differentiated nature and scope of regulation.. 16

VII.3. Hedge funds 17

VII.4. Credit rating agencies 17

VII.5. Supervisory colleges 17

VII.6. Securitisation 18

Part 2: Implementation at national and regional levels – planned next steps and schedules
(Input into the G20 Framework for Strong, Sustainable and Balanced Growth)

I. Building high quality capital and liquidity standards and mitigating procyclicality 19

II. Reforming compensation practices to support financial stability……….…………......... 20

III. Improving over-the-counter derivatives markets... 20

IV. Addressing systemically important financial institutions 21
V. Strengthening adherence to international supervisory and regulatory standards 22
VI. Strengthening accounting standards 23
VII. Other issues 23
VII.1. Developing macroprudential policy frameworks and tools 23
VII.2. Hedge funds 25
VII.3. Credit rating agencies 26
VII.4. Supervisory colleges 28
VII.5. Crisis management and resolution 28
VII.6. Risk management 29
VII.7. Securitisation 30

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Introduction

At the Pittsburgh Summit, the G20 Leaders stressed that the Financial Stability Board (FSB)'s ongoing efforts to monitor progress would be essential to the full and consistent implementation of needed reforms. This was echoed by the G20 Finance Ministers and Central Bank Governors, who agreed at their November 2009 meeting in St Andrews "to work with the FSB to maintain the momentum of our programme of reforms, and ensure their full, timely and consistent implementation and a level playing field".

This note describes the measures that have been taken and other progress made since the St Andrews meeting to implement the recommendations made by the G20 and the FSB for strengthening financial stability. The note consists of two complementary parts.

- The first focuses on the policy development work at international level.
- The second describes implementation at national and regional levels by FSB member jurisdictions of the G20 and FSB recommendations, which the FSB is also providing as an input into the mutual assessment process of the G20 *Framework for Strong, Sustainable and Balanced Growth*. It draws from information provided by FSB member jurisdictions on their planned next steps and schedules for each policy recommendation, including whether the implementation requires legislation or can take place within existing regulatory or supervisory powers.

The FSB will continue monitoring the implementation efforts both at international and national/regional levels and report again on progress to the G20 Leaders in advance of their Summit in June 2010.

Part 1: Policy development at the international level

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

The Basel Committee on Banking Supervision (BCBS) remains on schedule to issue a fully calibrated, comprehensive set of proposals by the end of this year. Two major consultation papers were published in December 2009 outlining the proposals to strengthen capital and liquidity regulation. Responses are due by mid-April. The key elements of the new proposals are:

- Measures to raise the quality, consistency and transparency of the capital base;
- Initiatives to strengthen the risk coverage of the capital framework, particularly in respect of counterparty credit exposures;
- Introduction of a leverage ratio as a supplementary backstop to the Basel II framework with a view to migrating to a Pillar 1 treatment based on appropriate review and calibration;
- Introduction of a countercyclical capital framework that promotes the build-up of capital buffers in good times that can be drawn down in periods of stress; and
- A new minimum liquidity standard for internationally active banks.

The BCBS is also working to develop proposals by the middle of the year on a number of key outstanding issues: the details of the proposed countercyclical regime; regulatory options for addressing systemically important institutions, as a contribution to the wider programme of work on such institutions (see Section IV below); and improvements to the provisioning framework, where the Committee is seeking an expected loss approach in name and substance. Following the release of the July 2009 trading book reforms, the BCBS also has initiated a fundamental review of the trading book, with a view to issuing concrete proposals for public consultation in the first half of 2011.

Alongside the consultation, the BCBS is undertaking a comprehensive "bottom-up" quantitative impact assessment (QIS) of how much minimum capital requirements will increase due to the reform proposals, as well as a detailed "top-down" assessment, which will determine the overall calibration of the new regulatory standards for capital and liquidity. The QIS covers the impacts of the December 2009 package, notably quality of capital and counterparty exposures, and the July 2009 amendments, covering the trading book and resecuritisations. It will also provide the basis for calibrating the leverage ratio in relation to the risk-based requirement. Bank results must be submitted by member countries to the BCBS Secretariat by 19 May.

The top-down calibration will assist the BCBS in the following:

- Calibration of the minimum capital and liquidity requirements to ensure the solvency and liquidity of individual banks at a given soundness standard, as well as the buffer above the minimum capital requirement to absorb plausibly severe system-wide stress and credit cyclicality.

- Assessing the long-run steady-state macro impact of the capital and liquidity frameworks. This long run impact assessment will help inform the calibration of the minimum and the buffers.
- Assessing qualitatively the incentives created by the new measures, including potential side effects and the impact on the unregulated sector.

Reports on the bottom-up QIS and the top-down calibration assessments will be reviewed by the BCBS in mid-July.

In addition, a joint FSB-BCBS Macroeconomic Assessment Group has been established under the chairmanship of the Bank for International Settlements (BIS) to assess the macroeconomic implications of the implementation of the reform proposals, in close collaboration with the International Monetary Fund (IMF). The group's main conclusions will be reviewed by the FSB and the BCBS at their respective meetings in mid-June and mid-July and will be taken into account in the framing of the appropriate transitional arrangements later this year.

The schedule for the whole programme remains unchanged. The BCBS will review a first draft of the revised reform package, including calibration proposals, at its July meeting. Based on guidance from that meeting, the Committee will present a fleshed out and calibrated package to the September meeting of Governors and Heads of Supervision (GHOS). To the extent there is a need for resolution of any major outstanding issues, a second meeting of the GHOS could be held in the first half of October. The reform package will then be submitted to the FSB and the G20 in advance of the November G20 Leaders Summit for finalisation by the end of the year. As previously announced by the Leaders in Pittsburgh, the standards will be phased in as financial conditions improve and the economic recovery is assured, with the aim of implementation by end-2012.

II. Reforming compensation practices to support financial stability

The FSB launched in December 2009 a review of the steps taken 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.[1]

Significant changes in regulatory and supervisory frameworks to implement the Principles and Standards have taken place across the FSB membership over the past year and are expected to continue into 2010 and beyond. Notwithstanding different starting points in terms of pre-existing national frameworks addressing compensation issues and the degree of misalignment with prudent risk-taking, there has been, on the whole, material progress and a movement towards convergence across jurisdictions. However, it is relatively early in the process; some key issues are yet to be resolved and effective implementation is far from complete. There are differences in the approach to and pace of implementation and a sustained and cooperative effort will be required from supervisors and financial institutions to implement fully the Principles and

[1] The compensation review is available at http://www.financialstabilityboard.org/publications/r_100330a.pdf.

Standards by the end of 2010. Greater progress has been achieved in the areas of governance, establishing supervisory oversight and promoting disclosure of compensation. Further work needs to be done to raise standards of risk adjustment of pay structures across the industry.

To maintain momentum, the FSB will conduct a further and more detailed review of implementation in the second quarter of 2011. We will also take additional measures in areas necessary to support the emergence of sound practice and further convergence. These include enhanced supervisory cooperation on compensation with regard to cross-border firms, especially across the major financial centres; support in the development of sound industry 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.

The BCBS has since initiated work to develop by end-October 2010 a consultative report on the range of methodologies for risk and performance alignment of compensation schemes and their effectiveness in light of experience to date. This work will be the main priority of the BCBS Task Force on Remuneration for the coming months.

The International Association of Insurance Supervisors (IAIS) released in March 2010 a draft of its *Standards and Guidance on Remuneration* for consultation among IAIS members and observers, with final publication as part of broader work on governance scheduled for autumn this year. This IAIS work supports the consistent implementation of the FSB Principles and Standards and highlights remuneration issues that are more specific to the insurance industry, such as the nature and complexity of an insurer's risk profile and the alignment with the long term interests of policyholders and beneficiaries.

The International Organization of Securities Commissions (IOSCO) issued in February 2010 a set of *Principles for Periodic Disclosure by Listed Entities* that provide guidance for annual disclosures to help investors to assess the incentives created by compensation and risk management practices, whether the incentives of the compensation are aligned with investors' interests and how performance may be oriented to the returns generated for shareholders. These principles apply to all listed companies.

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. Progress is being made to achieve implementation of these objectives, including industry efforts to meet commitments made to supervisors; multiple workstreams underway in international bodies and, as described in Part 2 of this report, legislative processes in major jurisdictions.

At the level of the industry, the so-called G14 major derivatives dealers and a number of buy-side institutions issued a joint letter on 1 March 2010 detailing further commitments to supervisors relating to OTC derivatives market transparency, expanded central clearing, standardisation and collateral management. These advance on the commitments made by firms in

September 2009 to specific target levels for central clearing of CCP-eligible OTC credit derivatives and CCP-eligible OTC interest rate derivatives. However, the enhanced clearing targets only partially cover the OTC market, as most derivative contracts are currently not CCP-eligible.

To support implementation of the G-20 clearing and trading objectives, in April 2010, at the initiative of the FSB, a working group led by the Committee on Payment and Settlement Systems (CPSS), IOSCO and the European Commission (EC) was formed to assess and set out policy options for promoting increased use of standardized products and for developing a clear process to implement at the global level mandatory clearing and exchange or electronic trading requirements. The work will cover definitions of product standardisation, clearing-eligibility and electronic-trading-eligibility; the relationship between product standardisation and policy objectives; and analysis of how policies to incentivize a shift to clearing of standardized products may be consistently implemented at the global level. The working group will suggest policy options to the FSB in October 2010.

The BCBS has proposed to raise capital requirements for OTC derivatives, and is now working to create stronger capital incentives to move such contracts to CCPs.

In addition, the CPSS and IOSCO are working on guidance to better address risks associated with clearing OTC derivatives in applying the existing CPSS-IOSCO standards for CCPs. The CPSS and IOSCO are also drafting a set of factors that global trade repositories and regulators should consider as repositories develop and operate in the OTC derivatives market. These initiatives are on track for completion by mid-2010, with draft reports for comment expected to be issued shortly. The CPSS and IOSCO are also conducting a review of CPSS-IOSCO standards for systemically important financial market infrastructure. A consultative document is expected to be published by end-2010 or early 2011, with interim updates in June and October.

The OTC Derivatives Regulators' Forum (ODRF), which began work in January 2009, has continued its work to promote cooperation and information-sharing regarding OTC derivatives CCPs and trade repositories, including promoting globally consistent oversight arrangements. The ODRF has set up working groups to establish harmonised data reporting standards.

IV. Addressing systemically important financial institutions and cross-border resolutions

The FSB has been working with its members to develop international policy reforms to address the moral hazard arising from systemically important financial institutions (SIFIs). The work has three main objectives: (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 contributions of these workstreams in a comprehensive and consistent framework. The FSB will provide an interim report on this project including likely policy options to the June G20 Summit and final recommendations to the 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. In particular, SIFI loss absorbency will be improved under proposals for higher quality capital and better transparency of the capital base. In addition to this, increased capital requirements for counterparty risk arising from derivatives, repos and security financing activities will mitigate some of the risks through interconnectedness with financial sector counterparties. Similarly, proposals for countercyclical buffers which are being considered will help to dampen the impact of unforeseen financial shocks.

Policy measures under active consideration that are more specifically focused at SIFIs include introducing higher prudential requirements such as a capital and/or liquidity surcharge, or leverage limit, calibrated to a measure of systemic externality; use of contingent capital; better micro- and macro-supervisory practices; and steps to limit the size, breadth and riskiness of institutions. The aim is to ensure that actions are sufficiently coordinated in order to maintain a level playing field, avoid regulatory arbitrage, and reduce systemic risks globally by ensuring that there is a common floor for standards.

The IMF/BIS/FSB joint paper issued in October 2009 set out a framework for assessing the systemic importance of a firm. Work is underway in the BCBS to calibrate an indicator based on size, substitutability and interconnectedness of firms. Some data sources to accomplish this have been identified and are being assessed for their appropriateness. This set of measures will then be considered for possible application of a systemic capital or liquidity surcharge, in combination with other supervisory measures, under a "guided discretion" approach. This work is complementary to the proposals made by the BCBS which are already being considered to strengthen capital requirements and introduce a leverage ratio and global minimum liquidity standards. Substantive progress is expected by June 2010.

The IMF was tasked by the G20 to present, by June 2010, a range of options countries can adopt so that the financial sector could make a fair and substantial contribution toward paying for any burden associated with government interventions to repair the banking system. A draft options paper analyses the costs incurred in the latest crisis and proposes forward-looking tax measures to reduce the probability and the cost of future financial crises.

It is important to consider how the possible imposition of capital or liquidity surcharges might or should interact with other measures being considered, such as systemic levies. Regulatory capital and liquidity surcharges and tax instruments can broadly be thought of as complements. The goal of capital and liquidity surcharges would be to charge the institution for its contribution to systemic risk and to lower the probability of failure at the institution level through the requirement to hold a higher capital/liquidity buffer. A systemic levy could recover or anticipate the fiscal costs associated with failure of a SIFI. The FSB, IMF and BCBS have prepared a preliminary study for the G20 assessing how possible capital/liquidity surcharges and taxes and levies relate to each other under the broader regulatory reform agenda. They will continue to work on these issues and will prepare more concrete impact assessments for the October meeting of G20 Finance Ministers and Governors.

Strengthened prudential requirements on SIFIs must be backed up by a strong supervisory regime, appropriately geared to systemic importance. Work is underway to collect lessons and critical success factors coming out of different national supervisory models as they apply to SIFIs. FSB members have initiated work to identify areas where the bar for intensity and effectiveness of supervision might be raised internationally.

Improving the capacity to resolve cross-border firms in crisis

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 underway in the FSB Cross-border Crisis Management Working Group is directed at achieving a better understanding of how large international firms could be resolved under existing national frameworks and how different frameworks interact. Crisis management groups, which consist of representatives from supervisory agencies, central banks and resolution authorities from the key home and host jurisdictions, have been established for the major international financial firms. The objective of these groups is to promote the elaboration of firm-specific recovery and resolution measures and to assess these firms' resolvability. Critical issues that will need to be addressed in such recovery and resolution plans include measures for preserving liquidity and making up cash flow shortfalls in various adverse situations, actions to scale down activities or sell business lines, as well as options for wind-down that authorities may apply.

The work on recovery and resolution planning may lead to less complex group structures that not only give authorities greater resolution options but also support more effective supervision. At the same time, it is not possible to resolve cross-border institutions strictly along national lines, which means that it is necessary to achieve greater coordination across borders. Significant issues remain to be resolved in this area at political level. The FSB will develop common principles that should help to achieve greater consistency among national resolution frameworks and to improve coordination of resolution measures across borders by October 2010.

These principles will draw on the BCBS recommendations on cross-border bank resolution, released in March 2010. These focus on enhancing authorities' resolution powers and national frameworks for a coordinated resolution of financial groups, and promoting effective procedures that facilitate cross-border information sharing and coordination of resolution measures. The recommendations call for resiliency and wind-down contingency planning to become a regular component of supervisory oversight and take into account cross-border interdependencies and the implications of complex group structures for effective resolution. They also call on national authorities to encourage simplification of group structures in a manner that facilitates effective resolution.

In parallel, the IMF is currently examining the principal legal and policy issues that arise in the insolvency of cross-border financial groups, the approaches that could be taken in addressing them and plans to lay out proposals for the design of an international framework governing the insolvency of a cross-border financial group in mid-2010.

The IAIS is developing standards which draws upon and considers the FSB *Principles for Cross-border Cooperation on Crisis Management* within the context of insurance.

Strengthening the core financial infrastructures and markets

An important cause of public intervention to avoid failure of a SIFI is their interconnectedness across market participants, especially vis-à-vis other SIFIs. The potential for contagion through counterparty or funding exposures can be reduced by disincentivising or limiting the exposures through capital or other requirements. Alternatively, contagion risk could be reduced through improvements to the robustness of core financial market infrastructures that tie SIFIs together.

This workstream encompasses a comprehensive review and strengthening of the standards and guidance for systemically important financial market infrastructures by the CPSS and IOSCO (see Section III); and strengthening the core financial infrastructures and markets to reduce contagion risks. It also includes the initiatives discussed in Section III to encourage the increased use of CCPs for OTC derivative transactions and the work of the OTC Derivatives Regulators' Forum to promote consistent public policy objectives and oversight approaches for OTC derivatives CCPs and trade repositories.

Market practices are being improved in important components of the wholesale market. A private sector task force will release a report with recommendation on how to mitigate risks related to tri-party repo transactions in the first half of 2010. IOSCO is reviewing jurisdictions' techniques for protecting client assets in the event of the insolvency of a financial institution, including regulatory arrangements providing for the segregation and protection of client assets held in the context of Collective Investment Schemes.

V. Strengthening adherence to international supervisory and regulatory standards

The FSB has begun to implement its framework for strengthening adherence to international regulatory and supervisory standards. Under this framework, the FSB will complete six peer reviews in 2010, the first of which was on compensation and was published in March (see Section II above). For more details on the future schedule of peer reviews, please see Part 2 of this report.

To strengthen global adherence to standards, the FSB launched in March 2010 an initiative to incentivise jurisdictions to improve their adherence to international cooperation and information exchange standards in the financial regulatory and supervisory area. 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.[2] Jurisdictions for which there is not sufficient evidence at present of adherence to these standards are being 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. The adherence of

[2] The initiative, including the criteria for identifying jurisdictions to be evaluated and process for evaluations is set out in the FSB note *Promoting global adherence to international cooperation and information exchange standards* available at http://www.financialstabilityboard.org/publications/r_100310.pdf.

jurisdictions to the relevant standards will be evaluated using information on compliance from Reports on the Observance of Standards and Codes (ROSCs) prepared by the IMF and World Bank, and Multilateral Memoranda of Understanding. Several countries have already requested Financial Sector Assessment Program (FSAP) assessments or ROSCs to be performed or updated following the launch of the initiative.

A variety of measures have been identified that could be used by the FSB to promote adherence to standards under this initiative. The FSB will seek to use positive measures in the first instance, such as policy dialogue and technical assistance, where possible and likely to be effective. Capacity-building mechanisms will be made available as needed to provide technical assistance. The FSB is currently reviewing the availability of capacity-building mechanisms to support this initiative. Negative measures are also available as appropriate, 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.

Through this initiative, the FSB is building on the work of other 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 *Multilateral Memorandum of Understanding concerning Consultation and Cooperation and the Exchange of Information* (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 provision of securities enforcement information amongst securities regulators.

VI. 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 complete their convergence project by June 2011. Progress continues to be made in widespread global adoption of the International Financial Reporting Standards (IFRSs) of the International Accounting Standards Board (IASB). Altogether more than 100 countries require or permit the use of IFRSs. Among major jurisdictions, Argentina, Brazil, Canada, China, India, Korea, Japan and Turkey are committed to adopt or permit the use of IFRSs, and Australia and the European Union (EU) have already adopted their use for listed companies.

In February 2010, the US Securities and Exchange Commission (SEC) issued a statement indicating that the SEC continues to believe that a single set of high-quality globally accepted accounting standards would benefit US investors. As a step toward achieving the goal, the SEC continues to encourage the convergence of US Generally Accepted Accounting Principles (GAAP) and IFRS in order to narrow the differences between the two sets of standards. The SEC will decide in 2011 whether to incorporate IFRSs into the US financial reporting system.

In November 2009, the IASB and the US Financial Accounting Standards Board (FASB) issued a joint statement, reiterating the IASB's and FASB's shared commitment to convergence by establishing a comprehensive work plan to complete their joint program by the June 2011 target. The Boards have been meeting monthly to achieve the goal of converging IFRSs and US GAAP to the greatest extent possible by June 2011. The IASB and FASB issued a Quarterly Progress Report on 31 March 2010, which indicated that they have achieved substantially all of their milestone targets for the first quarter of 2010.

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 continued work in a manner that does not expand the use of fair value in relation to the lending activities (involving loans and investments in debt instruments) of financial intermediaries. The FSB also encouraged the IASB and FASB to incorporate a broader range of available credit information than existing provisioning requirements, so as to recognise credit losses in loan portfolios at an earlier stage as part of an effort to mitigate procyclicality and supported continued work on impairment standards based on an expected loss model. The status of the IASB and FASB work in these areas is as follows:

- *Financial instruments: fair value measurement and lending activities.* In November 2009, the IASB issued IFRS 9, *Financial Instruments*, on classification and measurement of financial assets that establishes a mixed amortised cost and fair value accounting model. In response to comments from stakeholders, the IASB made changes to the approach set forth in its July 2009 exposure draft (ED). Some analysts and banks have noted that these changes increase the possibility that IFRS 9 once implemented may not expand fair value measurement for loans and investments in debt securities.[3] The impact of these changes on the use of fair value will become clearer as IFRS 9 is adopted by a broader sample of firms and as other revisions to IASB financial instruments accounting standards are implemented. While the effective date of IFRS 9 is January 1, 2013, the standard has been available for early adoption starting with 2009 annual reports, subject to the endorsement process in various jurisdictions.[4]

  In contrast to the IASB three-stage approach[5], the FASB retains its goal of issuing a single ED in the second quarter of 2010 that incorporates a single, comprehensive model for accounting for financial instruments. The FASB is preliminarily moving toward proposing an approach that is based on fair value measurement for all financial instruments, which will include balance sheet categories for (i) financial instruments for which changes in fair

[3] On the other hand, some other stakeholders are concerned that the final IASB standard may expand the use of fair value measurement.

[4] For example, the EC endorsement process for IASB standards must be completed before EU companies can implement IASB standards. In November 2009, the EC decided not to have an accelerated endorsement process for IFRS 9.

[5] The IASB is replacing its financial instruments accounting standards in three phases: classification and measurement, provisioning ("impairment"), and hedge accounting.

value are recognised in net income and (ii) financial instruments (including loans held to maturity) for which fair value changes are recognised in "other comprehensive income".

Although the two standard setters are developing separate proposals for their revised financial instruments standards, they are collaborating in their work. FASB and the IASB will consider together the comments received on the financial instruments EDs issued by the two Boards.

- *Expected loss provisioning.* In November 2009, the IASB also issued for public comment an ED on expected loss provisioning for financial assets reported at amortised cost. The FASB has preliminarily decided to focus on a credit impairment approach that would require, at the end of each period, an impairment loss measured as the present value of management's current estimate of cash flows that are not expected to be collected. One FASB Board member has described it as being a "short-term expected loss approach or an enhanced incurred loss approach". The FASB will further explain its credit loss impairment approach in its comprehensive ED in the second quarter of 2010.

  The IASB and FASB will continue discussions with each other to seek convergence in this area and the two bodies have established an Expert Advisory Panel (EAP) on impairment to assist the Boards in addressing a number of practical issues associated with their respective credit impairment (provisioning) approaches. The EAP, comprised of risk management and accounting experts from major banks and other financial firms, audit firms and regulatory bodies, has been meeting since December 2009.

  When forming the EAP, the IASB noted that the expected loss proposal has some complexity and operational challenges. The BCBS has been discussing with the IASB and EAP ways to further enhance the IASB's proposed expected loss approach in a manner that seeks to better integrate expected loss estimation processes with bank risk management systems, draw from information used for Basel II purposes, improve the quality of the expected loss estimates and mitigate risks of procyclicality while reducing undue burden on banks.

The FSB report to the Pittsburgh Summit, *Improving Financial Regulation*, had noted the following concern: "At present, the IASB and the US Financial Accounting Standards Board (FASB) are considering a variety of approaches which could possibly lead to divergences between IASB and FASB standards". We hope that the initiatives announced by the IASB and FASB Chairmen and the efforts of their Boards, including consideration of the comments of stakeholders, will result in improved and converged approaches in their final standards as recommended in the FSB report.

VII. Other issues

VII.1. Developing macroprudential policy frameworks and tools

Complementing the plans to apply nationally improved arrangements for systemic oversight (see Part 2 of this report), the FSB and its members are continuing work to develop policy tools to

constrain the build-up of macroprudential risks in the financial system. The FSB will take stock of progress in this area in June 2010.

Several of the initiatives described above have as clear objectives the reduction of system-wide or macroprudential risks. These include measures to enhance the resilience of banks and the banking system over the cycle through countercyclical capital buffers, more forward-looking credit loss provisioning rules, a leverage ratio as a supplement to the risk-based measure, higher capital requirements on intra-financial industry counterparty exposures, and capital surcharges to reduce the risks arising from SIFIs. In addition, the new minimum liquidity standard for internationally active banks will promote stronger funding over longer-term horizons and require that global banks have sufficient high-quality liquid assets to withstand a stressed funding scenario specified by supervisors. Each of these measures will reduce risks not only for individual institutions but for the system as a whole.

The Committee on Global Financial System (CGFS) published in March 2010 a report on the role of margin requirements and haircuts in procyclicality, based on a review of the system-wide impact of haircut-setting and margining practices in securities financing and OTC derivatives transactions during the recent financial crisis. A series of policy options are recommended to dampen the build-up of leverage in good times and soften the system-wide effects during a market downturn. The report also recommends consideration of measures that involve countercyclical variations in margins and haircuts, and enforcing higher and relatively stable through-the-cycle haircuts for securities financing transactions.

With regard to monitoring of system-wide risks:

- The IMF and the FSB are continuing to develop the early warning system.
- A set of macroprudential indicators has been developed by the BIS and CGFS to facilitate discussions of current financial conditions and risks, and will be used as input into FSB analysis of vulnerabilities and for the joint FSB/IMF Early Warning Exercise.
- An FSB working group has been established to develop templates for data collection on systemically important institutions' exposures to each other and to national markets and thereby facilitate network analysis. A progress report by the FSB and IMF on this and related efforts to address data gaps for financial stability purposes will be available in June 2010, and a more fully-fledged report will be available in November 2010.
- The BCBS and the CGFS are investigating aspects of systemic funding liquidity risk to gain a better understanding of aggregate liquidity shocks and to draw lessons for policy. Their report will be finalised in May 2010.

The IAIS is analysing the characteristics of systemic risk for the insurance sector with a view to developing a framework of appropriate policy responses. It is also exploring the development of macroprudential surveillance and tools for the insurance sector. The IAIS announced in January 2010 that it will develop a *Common Framework for the Supervision of Internationally Active Insurance Groups*. This framework will provide approaches to better monitor group structures, group business mix and intra-group transactions with a view to identifying risks and establishing

safeguards where necessary. A concept paper will be produced in 2011, with the full framework expected in 2013. Impact assessments will follow.

VII.2. Differentiated nature and scope of regulation

In January 2010, the Joint Forum, composed of the BCBS, IAIS and IOSCO, published its report on the *Differentiated Nature and Scope of Financial Regulation*. While the report covers a broad waterfront, the recommendations are focused on five key areas:

- *Key regulatory differences across the banking, insurance and securities sectors.* The report recommends that the core principles for these three sectors be reviewed and revised to ensure that they appropriately take into account systemic risk and the overall stability of the financial system. It recommends that the core principles be made more consistent across sectors and that common cross-sectoral standards be developed as appropriate to reduce regulatory arbitrage.
- *Strengthening supervision and regulation of financial groups.* Policymakers should ensure that all financial groups (particularly those providing cross-border services) are subject to supervision and regulation that captures the full spectrum of their activities and risks. The consistency of supervisory colleges across sectors should be enhanced.
- *Promoting consistent and effective underwriting standards for mortgage origination.* Supervisors should ensure that mortgage originators adopt minimum underwriting standards. Different types of mortgage providers should be subject to consistent standards and regulatory oversight. Appropriate public disclosure of market-wide mortgage underwriting standards should be established.
- *Broadening the scope of regulation to hedge fund activities*. Supervisors should introduce or strengthen appropriate and proportionate minimum risk management standards and impose reporting requirements for hedge fund operators. They should impose minimum capital requirements on operators of systemically important hedge funds. (Current regulatory developments relating to hedge funds are dealt with in more detail below in Parts I and II of this report.)
- *Strengthening regulatory oversight of credit transfer products.* Supervisors should encourage or require greater transparency for both credit default swaps (CDS) and financial guarantee products and should review prudential requirements for these instruments. The position of financial guarantee insurance in insurance regulation should be clarified. Supervisors should foster information-sharing and regulatory cooperation amongst each other.

In many of these areas, projects to implement the recommendations are underway. The Joint Forum has begun a review of its *Principles of Supervision for Financial Conglomerates*. The FSB will maintain oversight over policy implementation and follow up as necessary.

On 12 April, the IAIS published a *Guidance paper on treatment of non-regulated entities in group-wide supervision* to support insurance supervisors to address some of the key regulatory gaps observed in the global financial crisis and to minimise regulatory arbitrage opportunities.

The paper provides eight key features of group-wide supervision, including appropriate consideration of the complexity of group structures and the full spectrum of risks posed by non-regulated entities through measures such as capital adequacy and governance requirements.

VII.3. Hedge funds

In February 2010, IOSCO published an agreed 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.

VII.4. Credit rating agencies

National and regional initiatives are ongoing to strengthen oversight of credit rating agencies (CRAs). While these national developments 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. IOSCO will shortly report on whether differences in the implementation of national and regional regulatory frameworks based on its CRA Principles and *Code of Conduct Fundamentals* present compliance problems or arbitrage opportunities.

In response to the FSB and G20 recommendations to review the use of ratings in the regulatory and supervisory framework, the BCBS 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 or are considering ways of lessening undue reliance on ratings in rules and regulations. Despite this improvement, continuous challenge remains in this area, not least because it is often difficult to come up with objective proxies for CRA ratings. The FSB is collecting information on the measures taken both at international and national levels, and will examine the financial stability risks related to the official use of ratings as well as possible options and next steps for addressing these risks.

VII.5. Supervisory colleges

Core supervisory colleges for the more than thirty large complex financial institutions identified by the FSB as needing college arrangements have been in operation since last year. 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 and is undertaking a follow-up survey to assess the impact of this guidance. As part of the *Insurance Core Principles* review process, key features of the guidance paper might be elevated to become new standards.

IOSCO is working on principles for cooperation in the supervision and oversight of securities market participants, with the aim to report in the first half of 2010. The scope is broader than supervisory colleges and also covers supervisory cooperation with respect to a wider range of entities including systemically important hedge funds.

The FSB is reviewing the merits of developing overarching cross-sectoral principles to guide and improve the operation of supervisory colleges.

VII.6 Securitisation

Restarting 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. Nevertheless, despite initiatives by regulators, central banks and the private sector to rebuild confidence through improved market practices, the market has to date been slow to revive.

Since IOSCO's publication of the report of its Task Force on Unregulated Markets and Products in September 2009, the Task Force has undertaken a survey to review how members' jurisdictions are implementing the recommendations in the IOSCO report relating to securitisation.

In addition, in April 2010, IOSCO published Disclosure Principles for asset-backed securities (ABS) for regulatory regimes outlining the information which should be included in any offer document of ABS, including residential and commercial mortgage-backed securities. The new principles should contribute to enhancing investor protection by facilitating a better understanding of the issues that should be considered by regulators.

IOSCO is also examining the viability of post-trade transparency for structured products. It released a consultation report in September 2009, and expects to publish its final report shortly.

The FSB will study what further actions could be taken to encourage the revival of sound securitisation markets. It will consider areas such as transparency, disclosure and the alignment of incentives, and also whether there are any steps that could help to encourage the return of a suitable, well-regulated investor base.

Part 2: Implementation at national and regional levels - planned next steps and schedules

Input into the G20 Framework for Strong, Sustainable and Balanced Growth

The FSB has set up an Implementation Monitoring Network to monitor implementation by FSB member jurisdictions of the G20 and FSB recommendations for strengthening financial stability. The Network consists of experts from FSB member jurisdictions and international bodies.

From December 2009 through March 2010, the Network collected information on planned next steps and schedules for each policy recommendation. This part of the report summarises, as an input to the G20 mutual assessment process under the *Framework for Strong, Sustainable and Balanced Growth*, the information given by FSB member jurisdictions through this survey. This responds to the call of the G20 Finance Ministers and Central Bank Governors at St Andrews for the input of other international organisations including the FSB to assist their mutual assessment process.

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

Most FSB members have fully implemented Basel II. In countries where this is not the case, work is underway along the timeline committed by G20 Leaders to adopt Basel II "by 2011". In the US, banking agencies are preparing a notice of proposed rulemaking for the Standardised Approach, targeting spring 2010 for approval of a release for public comment. US supervisors will assess whether major firms' systems, models and data are adequate to qualify them to transition to the Internal Ratings Based Approach of Basel II. In China, formal applications by commercial banks to adopt Basel II following advanced approaches will be accepted up to end-June 2010, and Basel II will be adopted by end of 2010. Implementation in Turkey is expected in 2010. Indonesia is currently implementing Basel II but notes remaining challenges in ensuring successful implementation, including the need to enhance human resources capacity, develop infrastructure and strengthen banks' risk management systems.

Many jurisdictions are on course to implement by end-2010 the enhancements to the Basel II framework issued by the BCBS in July 2009 to raise capital requirements for the trading book, resecuritisations and exposures to off-balance sheet vehicles. For example, higher capital requirements for banks' trading books are included in the EU amendments to its Capital Requirements Directive (CRD), which is currently under its approval process (CRD3). The transposition of the directive to EU member states' regulations is due to be completed by end-2010.

Steps such as issuance of supervisory guidance and regulations are also being taken to incorporate the BCBS' principles for sound stress testing practices and for sound liquidity risk management. Several jurisdictions reported that their supervisors have been reviewing banks'

stress testing practices and whether their liquidity risk management is in line with the BCBS principles (see also Section VII.6. below).

Several countries noted that they are using a leverage ratio as a supervisory tool. Switzerland reported that they have significantly augmented in response to the crisis the Pillar 2 capital add-on with regard to the systemic international banks. The China Banking Regulatory Commission (CBRC) will issue draft supervisory guidelines on a leverage ratio and countercyclical capital buffer for public consultation in the near future. The CBRC in October 2009 has also introduced stricter constraints on capital quality that require commercial banks to deduct cross-holdings of subordinated debt from Tier 2 capital, while reducing the ceiling of the ratio of subordinated debt to Tier 1 capital from 50% to 25%.

II. Reforming compensation practices to support financial stability

The FSB concluded in March 2010 a review of the steps taken by FSB member jurisdictions to implement the *FSF Principles for Sound Compensation Practices* and their *Implementation Standards*. These steps are summarised in the Annex attached to this report. The review also covered progress to date in implementation by significant financial institutions. The findings and recommendations of the review are described in Part 1 of this report.

III. Improving over-the-counter derivatives markets

Various efforts are underway at national levels to promote the standardisation and resilience of OTC derivatives markets and to establish CCPs and trade repositories:

- CCPs have already been introduced to clear CDS in the US. The House of Representatives has passed the "Wall Street Reform and Consumer Protection Act" and the Senate is considering the "Restoring American Financial Stability Act", both of which would give the Commodity Futures Trading Commission and the SEC jurisdiction over OTC derivatives. Included in the House legislation are provisions that would specifically require that all "clearing-eligible" OTC derivatives transactions be cleared through regulated CCPs and traded on exchanges or alternative swap execution facilities. Under the proposed legislation, non-cleared transactions must be reported to trade repositories, and would be subject to more stringent capital requirements than transactions cleared through a CCP. Once the Senate passes its legislation, the bill must be reconciled with that of the House of Representatives.
- In the EU, where CCP clearing for the standardised part of the CDS market has also come into operation, the EC issued in October 2009 a Communication on future policy actions in the area of derivatives. These include: (i) a harmonised legal framework for CCPs; (ii) mandatory requirement to clear standardised contracts; (iii) mandatory supply of initial and variation margins; (iv) substantial differentiation of bilaterally cleared and CCP cleared transactions; (v) possible revision of the operational risk requirements in the CRD to foster standardisation; (vi) legislation on trade repositories; (vii) mandatory registration of transactions in trade repositories; (viii) increased transparency requirements, and (ix)

extension of scope for the market abuse directive. Following the Communication, a legislative proposal on requirements for CCPs and trade repositories and on mandatory clearing and reporting requirements will be adopted in mid-2010; and revision of the CRD and Markets in Financial Instruments Directive is planned by end-2010.

- In-depth research of the Canadian OTC derivatives markets has been undertaken in the first quarter of 2010 and a regulatory framework proposal developed in parallel, to ensure changes harmonised with the details of proposed US and European legislation.
- In China, the Shanghai Clearing House was incorporated in November 2009 and will gradually provide CCP clearing services for OTC derivatives.
- In Japan, the Financial Services Agency (J-FSA) presented to the Diet in March 2010 a draft bill that will introduce mandatory CCP clearing, data storage of trade information and reporting requirements. Discussion is also ongoing to launch CCP services for OTC derivatives transactions in 2010.
- The Russian government is considering a draft federal law that sets out the concept of CCP and formulates the requirements for supervision and regulation of its risks.
- In South Africa, proposed amendments to the Security Services Act, including proposals to shift derivatives onto a CCP, have been finalised and are scheduled to be submitted to the Parliament in the second half of 2010.

As regulatory reform proposals for OTC derivatives markets proceed in different countries, divergences are becoming evident which may be susceptible to regulatory arbitrage. Regulators need to continue to coordinate their efforts and achieve consistent design and implementation of new rules, to ensure a level playing field and to address potential concerns about market fragmentation.

IV. Addressing systemically important financial institutions

Authorities are making various efforts in response to G20 Leaders' call at Pittsburgh for consistent, consolidated supervision and regulation of systemically important firms. While many authorities reported they are already supervising financial institutions on a consolidated basis, additional legislative and supervisory initiatives have been implemented or are underway in several jurisdictions:

- In Germany, the provisions in the BaFin circular "Minimum Requirements for Risk Management" have been expanded regarding consolidated risk management, with a new subchapter on risk management at group level.
- In Japan, the J-FSA presented to the Diet in March 2010 a draft bill introducing consolidated regulation and supervision for securities companies and consolidated prudential standards for insurance companies.
- Legislation proposed in the US in summer 2009 would impose strong oversight on a consolidated basis on all financial firms whose failure could pose a threat to financial

stability, regardless of whether the firm owns a bank. Elements of this supervision would include: (i) higher capital and liquidity standards; (ii) single-counterparty credit exposure limits on systemic firms; (iii) new prompt corrective action requirements on systemic firms; (iv) requiring rapid resolution plans; and (v) strengthening firewalls between insured depository institutions and their affiliates. US insurance regulators are also introducing enhancements to group supervision.

Various other measures are ongoing to intensify supervision and improve supervisory cooperation within and across borders. These include the establishment of supervisory colleges (see Sections VII.4 below).

Efforts are also being made to improve resiliency by reducing interconnectedness. The US Administration proposed in January 2010 mandatory limits on proprietary trading by banks and bank holding companies, and related restrictions on owning or sponsoring hedge funds or private equity funds, as well as on the concentration of liabilities in the financial system.

Work is proceeding to promote effective contingency planning and develop recovery and resolution plans for major global financial institutions. This includes the establishment of firm-specific cross-border crisis management groups and steps to improve national resolution tools and frameworks (see Section VII.5 below).

Various actions are also being taken or considered to strengthen the core financial infrastructures and markets, as mentioned in Section III above.

V. Strengthening adherence to international supervisory and regulatory standards

The FSB *Framework for Strengthening Adherence to International Standards*, published in January 2010, aims to promote a race to the top. FSB member jurisdictions have committed to lead by example by implementing international financial standards in full, undergoing an assessment under the IMF-World Bank FSAP every five years, participating in thematic and country peer reviews of FSB members, and publishing the results of these assessments.

Thematic peer reviews will focus on the implementation across the FSB membership of policies or standards agreed within the FSB. The FSB will conduct three thematic reviews in 2010. Following the successful completion of the review of compensation, the next thematic review will examine risk disclosures by market participants. It will follow up on the implementation of the recommendations regarding risk disclosures contained in the April 2008 Report of the Financial Stability Forum (FSF) on *Enhancing Market and Institutional Resilience*.

Country peer reviews will focus on implementation in a specific member jurisdiction, notably through follow-up to relevant recommendations arising from a recent IMF-World Bank FSAP. Based on the schedule of recently completed FSAPs, Italy, Mexico and Spain will each undergo a country peer review in 2010.

For details on the FSB's global initiative to incentivise jurisdictions to improve their adherence to international cooperation and information exchange standards in the financial regulatory and supervisory area, see Part 1 of the report.

VI. Strengthening accounting standards

Efforts are ongoing in many FSB member countries to converge with or adopt IFRSs of the IASB by 2012:

- IFRSs will replace Canadian GAAP for publicly accountable enterprises on 1 January 2011.
- In China, full convergence with IFRS will be completed by end-2011.
- The Institute of Chartered Accountants of India has announced the mandatory convergence of Indian Accounting Standards with IFRS from 1 April 2011. A roadmap for mandatory convergence of corporates in a phased manner has been announced, and a separate roadmap for convergence of banks and insurance companies is under preparation.
- In Japan, the J-FSA amended the government orders in December 2009 so that listed companies operating globally can adopt IFRS voluntarily for their consolidated financial statements for the fiscal year ending on or after 31 March 2010. Japan will decide on the mandatory use of IFRS around 2012.
- The State Council of Russia is considering the draft Federal Law on consolidated financial statements, which establishes a legal basis for full mandatory use of the IFRS by Russian listed companies when preparing consolidated financial statements.
- In February 2010, the US SEC issued a statement that set forth its position regarding global accounting standards. The SEC continues to believe that a single set of high-quality globally accepted accounting standards would benefit US investors. As a step toward achieving the goal, the SEC continues to encourage the convergence of US GAAP and IFRS in order to narrow the differences between the two sets of standards. It will decide in 2011 whether to incorporate IFRSs into the US financial reporting system.

Meanwhile, national accounting standard setters are continuing to review their standards to keep pace with the IASB's efforts in response to the G20 and FSB recommendations, including for improvement with respect to fair value measurement and disclosure; financial instruments accounting; and off-balance sheet activities.

Section VI in Part 1 of this report includes a discussion of international efforts to converge accounting standards.

VII. Other issues

VII.1. Developing macroprudential policy frameworks and tools

Efforts to establish system-wide oversight and macroprudential policy arrangements are ongoing at the national and regional levels:

- Canada has a project to establish a federal securities regulator with a financial stability mandate, although some legal uncertainty remains as to whether the Parliament has the constitutional authority to enact and implement a federal securities regulatory regime.

- The EC has developed a financial supervision legislative package that includes measures to establish a two-pillar structure of a European Systemic Risk Board (ESRB), which shall be responsible for the macroprudential oversight of the EU financial system as a whole, alongside a European System of Financial Supervisors, focusing on micro-prudential supervision. The ESRB would collect and analyse all the information relevant for assessing potential threats to financial stability that arise from macroeconomic developments and from developments within the financial system as a whole. It would issue warnings of a general nature or concerning individual members where risks are deemed to be significant and, where appropriate, issue recommendations for action to deal with these risks. It would also monitor compliance with its recommendations. The ESRB is envisaged to begin operations at the beginning of 2011.
- In France, banking and insurance authorities have recently merged to create a new Prudential Authority. This aims to strengthen financial stability by establishing a supervisory authority capable of monitoring risks across financial sectors and eliminating "blind spots" in the monitoring. To strengthen the regulation of the financial sector and the markets, a Council for financial regulation and systematic risk will be established by the end of 2010. Chaired by the Minister of Finance, the Council will gather all the supervisory authorities of the financial sector in order to analyse the situation of the financial sector and markets in France from a macroprudential point of view and to assess the systemic risk. It will ease the cooperation and the synthesis of the work to implement European and international financial sector rules.
- The new Financial Services Act, which came into effect in April 2010, has put on a statutory basis a number of arrangements to strengthen the UK's financial stability framework with an enhanced focus on systemic risk, including a statutory financial stability objective for the Financial Services Authority (FSA). In addition, a new committee (the Council for Financial Stability) has been established, consisting of the Chancellor, FSA Chairman and Governor of the Bank of England. The objective of the Council is to analyse and examine emerging risks to the financial stability of the UK economy and coordinate the appropriate response.
- In the US, regulatory reform legislation is being discussed in Congress that would create a Financial Services Oversight Council to oversee systemic risk across the financial system and identify threats to financial stability.

Some jurisdictions are taking steps to enhance information sharing among domestic authorities. In Germany, BaFin and Bundesbank have recently formed a joint Risk Committee to link macro- and microprudential supervision. Information sharing arrangements and regulatory MoUs have been signed among the relevant Chinese authorities.

While many jurisdictions consider their authorities to have significant powers for gathering relevant information to gauge systemic risk, additional efforts are underway in some countries for better information gathering. For example:

- The Australian Financial Sector Legislation Amendment Bill of 2010 aims to further enhance Australian Prudential Regulation Authority (APRA)'s data gathering and sharing powers by giving APRA the power to collect data from any entity providing financial services for the purpose of ensuring financial system stability.
- The Autorité des Marchés Financiers in France established an in-house Risk Committee on 1 January 2010 to identify risks at an early stage, and extended its scope of supervision to all markets and products including OTC derivatives markets.
- The Financial Services Act provides the UK FSA with greater powers to seek information from non-regulated entities, where the information concerned is relevant to the financial stability either of individual financial institutions or of one or more aspects of the financial system. This includes the power to collect information from non-regulated financial services firms and providers of critical services to such firms (e.g. IT suppliers) and the power for Treasury to extend the scope of information-gathering powers in future.

Although many efforts are underway, some jurisdictions reported that the development of macroprudential regulation and supervision remains in its early stages, and supervisory practices, governance frameworks (mandates, information gathering powers, coordination arrangements, etc) and policy tools for a better macroprudential analysis are currently under study.

Some jurisdictions are reviewing the scope and adequacy of their regulatory framework to identify and fill potential gaps. Various steps are being taken with regard to the hedge funds, CRAs, OTC derivatives, etc (see relevant sections of this report).

VII.2. Hedge funds

In addition to the regulatory frameworks that already apply to hedge funds or hedge fund managers (e.g., on registration/licensing and reporting requirements, funding limits, "fit-and-proper" and risk management requirements), countries are taking other steps to ensure appropriate oversight and regulation of hedge funds:

- In Canada, a new regulation came into force in September 2009 that requires hedge fund managers to be registered under securities laws. Canadian authorities are now considering information requirements and options for oversight of hedge funds in relation to systemic risk, including requirements based on size.
- An EC legislative proposal that establishes regulatory and supervisory standards for hedge funds, private equity firms and others is currently under consideration in the Council of Ministers and European Parliament. The proposal requires all managers above a certain threshold to be authorised, to disclose appropriate information to regulators, and to comply with a set of organisational and operational requirements including on risk management. The proposed directive will require transposition into the national legal systems of EU member states.
- In December 2009, the US House of Representatives passed an Act which includes provisions requiring certain hedge fund advisers to register with the SEC and to maintain and file with the SEC certain records and reports detailing, for certain hedge funds they

manage, the fund's: (i) assets under management; (ii) use of leverage; (iii) counterparty credit risk exposure; (iv) trading and investment positions; and (v) trading practices, as well as other specified information. The Senate is still considering its own legislation, and the US Administration continues to pursue regulatory reform.

- The UK-FSA and the US SEC are working together as the two major hedge fund manager domiciles to develop a common framework for the collection and sharing of systemic information regarding hedge funds.

Some countries reported that they do not have a specific regulatory framework for hedge funds, largely because hedge funds are not of systemic importance in their domestic financial systems. Other factors may be that they do not see a need for a specific regulatory framework for the protection of professional investors or that, rather than having a specific regulatory framework, they apply the same standards to hedge funds as other asset managers.

Many jurisdictions reported that prudential regulations and supervision are already in place for financial institutions that operate with hedge funds as counterparties. These include information requirements, requirements for effective risk management, and other prudential measures including a higher risk weight and limits on large exposures. Supervisors are monitoring their financial institutions' counterparty exposures to identify any exposures that may give rise to concern and assess the effectiveness of counterparty risk management. Some jurisdictions reported that they have revised or plan to review supervisory guidance and prudential standards to strengthen counterparty credit risk management.

VII.3. Credit rating agencies

National and regional initiatives are ongoing to strengthen oversight of CRAs:

- In September 2009, the US SEC proposed additional amendments to its rules on nationally recognised statistical rating organisations (NRSROs) in order to strengthen its regulatory framework for CRAs. The proposals included enhanced disclosure requirements, including requiring annual compliance reports and enhanced disclosure of potential sources of revenue-related conflicts, as well as proposed new rules that would require disclosure of information such as what a credit rating covers and any material limitations on the scope of the rating and whether there was "ratings shopping". Also in September 2009, the SEC amended its rules to require that NRSROs publicly disclose all ratings and rating actions issued on or after June 2007. In addition, the SEC solicited comments regarding alternative measures that could be taken to differentiate NRSROs' structured finance credit ratings from the credit ratings they issue for other types of financial instruments through, for example, enhanced disclosures of information.

- An EU regulation introducing oversight and supervision of CRAs entered into force in December 2009. All CRAs that would like their credit ratings to be used in the EU need to apply for registration and comply with rules requiring that (i) ratings are not affected by conflicts of interest; (ii) they remain vigilant on the quality of the rating methodology and the ratings; and (iii) they act in a transparent manner and disclose information related to the performance track record of the different ratings categories. Ratings for structured products

must be clearly differentiated from other ratings by using an additional symbol. Later this year, the Committee of European Securities Regulators (CESR) will issue guidance on various topics including the registration process and supervisory practices for CRAs. Eventually, 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 Japan, the final version of a cabinet order and cabinet office ordinances were published in December 2009. This follows a bill in June 2009 introducing a new regulatory framework for CRAs. The ordinances include provisions on differentiation of ratings for structured products and disclosures of rating history and material information used in the rating process. Under the ordinances, an exemption scheme was put in place whereby the J-FSA will approve exemptions from a number of operational control requirements which may bring about certain overlaps or inconsistencies with regulations in the home jurisdiction of a foreign registered CRA. This will contribute to avoid compliance problems for global CRAs. The regulations became effective on 1 April 2010.
- Licensing of CRAs took effect in Australia from 1 January 2010. Compliance with the IOSCO *Code of Conduct Fundamentals* for CRAs will be a mandatory licensing condition from 1 July 2010.
- The Canadian authority is aiming to publish for comment a proposed rule on a regulatory oversight framework for CRAs. Legislative amendments will be required before the rule can come into effect.
- The revision of CRA-related regulations in Korea took effect in October 2009, making it mandatory for CRAs to (i) establish internal processes to ensure rating accuracy and prevent conflict of interest; (ii) disclose rating methodology and rating process on structured products as well as their underlying assets; and (iii) disclose rating performance reports and data.
- Mexico is working on a new regulatory framework to improve the quality, transparency and integrity of the rating process and avoid conflicts of interest, while developing guidelines for rating structured products.
- A draft CRA Bill is under discussion in South Africa for submission to the Parliament by mid-2010. Practices and procedures in line with IOSCO recommendations will be incorporated in the regulations accompanying the Bill.

While these developments 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 are continuing their discussions to resolve issues relating to cross-border transferability of credit ratings and any other significant inconsistencies or frictions that may arise as a result of differences among their new CRA regulations.

National and regional authorities have also taken or are considering steps to lessen undue reliance on ratings in rules and regulations. In September 2009, the US SEC adopted

amendments removing references to NRSRO ratings in several rules and forms, and proposed for comment additional amendments which would remove such references from other rules and forms as well.

VII.4. Supervisory colleges

Core supervisory colleges have been established for large complex financial institutions identified by the FSB as needing core college arrangements. These colleges met in 2009, and have established schedules for further meetings in 2010 and beyond.

One key challenge is to ensure that discussions are sufficiently open and candid within the colleges so that they improve the quality and effectiveness of supervision. Italy noted that a multilateral MoU is being finalised to discipline the information exchange within their supervisory colleges.

Some jurisdictions reported that they have established or plan to establish colleges for other financial institutions. For example, all European cross-border banking groups will need to have a college in place by end-2010 following requirements in CRD2; and the Solvency II Directive requires that colleges are established for all cross-border insurance groups by end-October 2012.

VII.5. Crisis management and resolution

Work is ongoing to implement the FSB *Principles for Cross-border Cooperation on Crisis Management*. Firm-specific cross-border crisis management groups have been established for the major global financial institutions requiring FSB core supervisory colleges; and discussions are underway for development of effective contingency planning and resolution plans. The work is coordinated through the FSB Cross-border Crisis Management Working Group.

While some countries estimate that they already have adequate resolution regimes that meet the recommendations set out in the report of the BCBS on *Cross-border Bank Resolution* issued in March 2010, other countries reported on actions to review their resolution tools and frameworks for the effective resolution of financial groups:

- Legislation is scheduled in Australia for passage and commencement in 2010, with the aim to further enhance the effectiveness of APRA's crisis management powers.
- The Central Bank of Brazil has issued for public comment in October 2009 a study for a legislative proposal, including preventive measures to reduce the probability of failure of financial institutions and facilitate their orderly resolution.
- A public consultation process ended in January 2010 on a Communication by the EC that sets out an EU framework for cross-border crisis management in the banking sector.
- In France, the new Prudential Authority that was created by merging the licensing and supervisory authorities for banks and insurance companies has been provided with new powers relevant to bank resolution.

- Germany is currently preparing appropriate measures to improve their current framework and to introduce resolution mechanisms that would enable the competent authorities to deal with the failure of systemically important banks.
- Mexico has a plan to develop a bankruptcy procedure for banking institutions.
- The UK implemented a new Banking Act in February 2009, which established the legal framework for a Special Resolution Regime that gives the UK authorities a variety of tools to resolve a failing bank, with a clear definition of the role of each authority. The UK has legislated for recovery and resolution plans (RRPs) in the Financial Services Act 2010 and a pilot RRPs project involving a small number of large UK banks is progressing to timetable. A public consultation is underway on the resolution arrangements for investment banks in the UK.
- The US House of Representatives passed a bill in December 2009 to give the US government resolution tools needed to resolve systemic non-bank financial firms. US Treasury and the banking agencies are working actively with the Congress to assist in the drafting of legislation that would create a more effective resolution framework and provide the tools for the resolution of financial groups.

Many countries reported that the deposit insurance systems in their jurisdictions meet the *Core Principles for Effective Deposit Insurance Systems* issued by the BCBS and International Association of Deposit Insurers. Argentina reported that it is going to assess the current deposit insurance system to determine whether it needs to be strengthened considering the international principles. In the EU, legislative proposal to revise the Directive on Deposit Guarantee Schemes is being prepared. Chinese authorities are working together to draft a deposit insurance regulation; and the Australian government has committed to initiate a review of depositor protection arrangements by October 2011. On the other hand, Saudi Arabia noted that it has not considered offering a deposit insurance scheme because the need for the scheme is not warranted given the robust fundamentals of its economy and the strength of its banking sector.

VII.6. Risk management

FSB member jurisdictions are taking steps to implement the BCBS supplemental guidance under the Pillar 2 supervisory review process of Basel II, issued in July 2009. The guidance raises standards for firm-wide governance and risk management; capturing the risk of off-balance sheet exposures and securitisation activities; and the management of risk concentrations. Steps are also being taken to incorporate the BCBS principles for sound stress testing practices and for sound liquidity risk management. Some countries noted that they are asking the financial industry to improve risk management practices in line with the recommendations of the Senior Supervisors Group.

Stress tests are being conducted in many jurisdictions, in some cases using a common economic scenario and methodologies developed by the authorities. Stress test results are taken into account in the assessment of financial institutions' capital adequacy and liquidity management, and are used as important inputs into ongoing supervision. The UK FSA introduced in December 2009 a new reverse stress testing requirement for firms and provided firms with additional

guidance on the appropriate severity and calibration of Pillar 2 capital planning stress tests including the publication of a supervisory recommended scenario in March 2010 for firms to use as an anchor scenario.

In addition to stress tests done by financial institutions, supervisors are often conducting stress tests of their own to assess the resilience of their financial system both at system-wide and institutional level. The key focus is to strengthen the link between macroprudential, sector-wide analysis and microprudential, institution-specific supervision.

Efforts are also underway to implement enhancements to Basel II Pillar 3, announced by the BCBS in July 2009 to strengthen disclosure requirements for securitisations, off-balance sheet exposures and trading activities. Several jurisdictions reported that their supervisory authorities have encouraged their financial institutions to provide enhanced risk disclosures in their financial reporting, following the recommendations of the FSF's April 2008 report on *Enhancing Market and Institutional Resilience*. The FSB will follow up in its next thematic review on the implementation of these recommendations. In the EU, the Committee of European Banking Supervisors (CEBS) issued for consultation in October 2009 guidelines intended to help institutions to improve their disclosures in stress situations. The CEBS also published in June 2009 its reports on banks' annual and Pillar 3 disclosures. In November 2009, the CESR published the findings of an analysis of financial instruments disclosures in the 2008 annual reports of large European listed financial institutions.

VII.7 Securitisation

Authorities have proposed a number of initiatives to strengthen practices in securitisation markets in alignment with the IOSCO recommendations issued in September 2009. These include initiatives to improve transparency and reporting in major jurisdictions:

- The ECB launched a public consultation in December 2009 regarding the establishment of loan-by-loan information requirements for ABS eligibility in the Eurosystem collateral framework. The consultation should inform changes in ABS eligibility criteria expected to be announced in spring 2010 and implemented by spring 2011.
- The Bank of England launched a public consultation in March 2010 on its initiative to require greater transparency, including periodic reporting of loan-level data; provision of a summary of the key features of the transaction structure in a standardised format; and public availability of cash-flow models. Comments are due by end-April 2010.
- The US SEC proposed rules in April 2010, which would provide investors with more time to consider transaction-specific information, including specified information about each of the assets in the pool. Issuers would also be required to publicly file a computer program of contractual cash flow provisions. The proposal has a 90-day public comment period.

Initiatives are also being taken to introduce retention requirements for securitisations or other forms of loan sales:

- In the US, a bill was passed by the House of Representatives in December 2009, which would require creditors that originate loans to retain an economic interest in a material

portion of the credit risk of the loan upon transfer, sale or conveyance to a third party. The bill provides that creditors would be required to retain at least 5 percent of the credit risk on the transferred loan. The bill must be reconciled with the Senate bill when the latter is passed.

- In the EU, retention requirements for originators/sponsors of securitisations and enhanced risk management practices for securitisation portfolios (due diligence) have been included in CRD2 and will be effective for securitisations issued as from 1 January 2011 (with a grandfathering clause for previous ones). Further strengthened due diligence requirements in particular with regard to resecuritisations have also been proposed by the EC as part of the CRD3 review.
- Some other countries also note they are reviewing the recommendations of the IOSCO Task Force on Unregulated Markets and Products, including considering retention requirements for securitisation.

Moves to strengthen the capital requirements for banks relating to securitisation are described in Section I above.

FSB FINANCIAL STABILITY BOARD

Annex

Status of national implementation of the FSB Compensation Principles and Standards (Extract from the Thematic Review on Compensation – Peer Review Report (30 March 2010))

The table below provides a preliminary snapshot of implementation initiatives in FSB member jurisdictions. The table does not provide an assessment of the degree of compliance with the particular Principle or Standard, rather an indication of whether regulatory or supervisory initiatives are underway to implement a Principle or Standard (or elements thereof);[6] initiatives are at the preparatory stage (i.e., regulation or supervisory guidance being drafted or under consultation); under consideration; or not currently underway. The table was developed by the FSB Secretariat based on the responses to the template provided by members, and national entries have been checked for accuracy by the relevant authorities.

The Principles and Standards are listed in the order followed in the compensation review template (Annex B). For the full text of the Principles and Standards, see Annexes C–D.

	AR	AU	BR	CA	CN	FR	DE	HK	IN	ID	IT	JP	KR	MX	NL	RU	SA	SG	ZA	ES	CH	TR	UK	US
Effective governance of compensation																								
P1	IP	R	IP	S	S	R	R	S	R	IP	R	S	S	IP	R	S	R	R	IP	S	R	IP	R	R
P2	IP	R	IP	S	S	R	R	S	R	IP	R	S	S	IP	R	S	R	S	IP	S	R	IP	R	S
S1	IP	R	IP	S	S	R	R	S	UC	IP	R	S	S	IP	R	S	R	R	IP	S	R	IP	R	R
P3	IP	R	IP	S	S	R	R	S	UC	IP	R	S	S	IP	S	R	R	R	IP	S	R	IP	R	S
S2	IP	R	IP	S	S	R	R	S	UC	UC	R	S	S	IP	S	S	R	R	IP	S	R	IP	R	S
Effective alignment of compensation with prudent risk taking																								
P4	IP	R	IP	S	S	R	R	S	UC	UC	R	S	S	IP	R	UC	R	R	IP	S	R	IP	R	S
S3	IP	R	IP	S	S	R	IP	S	UC	UC	R	S	S	IP	S	UC	R	R	IP	S	R	IP	S	R
S4	IP	R	IP	S	S	R	R	S	UC	UC	R	S	S	IP	S	UC	R	S	IP	S	R	IP	R	S
P5	IP	R	IP	S	S	R	R	S	UC	UC	R	S	S	IP	R	UC	R	S	IP	S	R	IP	R	S
S5	IP	R	IP	S	S	R	R	S	UC	UC	R	S	S	IP	R	UC	R	S	IP	S	R	IP	R	S

[6] As stated elsewhere in this report, effective implementation of the Principles and Standards can be achieved through a variety of approaches, including different mixes of regulation and supervisory oversight.

	AR	AU	BR	CA	CN	FR	DE	HK	IN	ID	IT	JP	KR	MX	NL	RU	SA	SG	ZA	ES	CH	TR	UK	US
P6	IP	R	IP	S	S	R	R	S	UC	UC	R	S	S	IP	R	UC	R	S	IP	S	R	IP	R	S
S6	IP	S	IP	S	S	R	R	S	UC	UC	R	S	S	IP	R	UC	R	S	IP	S	R	IP	R	S
S7	IP	S	IP	S	S	R	R	S	UC	UC	R	S	S	IP	R	UC	R	S	IP	S	R	IP	R	S
P7	IP	S	IP	S	IP	R	R	S	UC	UC	R	S	S	IP	R	UC	R	S	IP	S	R	IP	S	S
S8	IP	S	IP	S	IP	R	R	S	UC	UC	S	S	S	IP	IP	UC	R	S	IP	S	R	IP	UC	S
S9	IP	S	IP	S	S	R	R	S	UC	UC	R	S	S	IP	R	UC	R	S	IP	S	R	IP	R	S
S11	IP	S	IP	S	S	R	R	S	UC	UC	S	S	S	IP	R	UC	R	S	IP	S	R	IP	S	S
S12	IP	S	IP	S	S	R[i]	R	S	UC	UC	R	S	S	IP	IP	UC	R	S	IP	S	R	IP	S	S
S14	IP	S	NA	S	S	R	R	S	UC	UC	R	S	S	IP	IP	UC	S	IP	IP	S	UC	IP	NA	UC
Effective supervisory oversight and engagement by shareholders																								
P8	IP	S	IP	S	S	R	S	S	UC	S	S	S	S	IP	S	S	S	S	IP	S	R	IP	S	S
S10	IP	NA	IP	UC	S	R	R	R	UC	R	R	R	S	IP	R[ii]	R	R	R	NA	UC	R	R	R	R
S13	IP	S	IP	S	S	R	R	S	UC	UC	R	S	S	IP	S	S	S	S	IP	S	S	IP	S	S
S16	IP	S	IP	S	S	R	S	S	UC	S	S	S	S	IP	S	S	S	S	IP	S	S	IP	S	S
S17	IP	R	IP	S	S	R	R	S	UC	UC	S	S	S	IP	R	S	S	S	IP	S	R	IP	S	S
S18	IP	S	IP	S	S	R	R	S	UC	UC	S	S	S	IP	S	S	R	S	IP	S	R	IP	R	S
P9	IP	R	IP	S	S	R	R	S	UC	R	R	R	S	IP	R	R	R	S	IP	S	R	IP	R	R
S15	IP	R	IP	S	S	R	R	S	UC	UC	R	S	S	IP	R	R	R	IP	IP	S	R	IP	IP	R

Legend: R – regulatory approach (including applicable laws, regulations, and a mix of both regulation and supervisory oversight); S – supervisory approach (including supervisory guidance and/or oversight); IP – initiatives under preparation; UC – initiatives under consideration; NA – not addressed or not relevant. *(S19 not included.)*

Acronyms: AR – Argentina; AU – Australia; BR – Brazil; Ca – Canada; CN – China; FR – France; DE – Germany; HK – Hong Kong; IN – India; ID – Indonesia; IT – Italy; JP – Japan; KR – Korea; MX – Mexico; NL – Netherlands; RU – Russia; SA – Saudi Arabia; SG – Singapore; ZA – South Africa; ES – Spain; CH – Switzerland, TR –Turkey; UK – United Kingdom; US – United States.

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[i] Regulation applies only for corporate executives but not for market operators.

[ii] The provision is laid down in an agreement between the government and the financial sector.