CB(1)837/08-09(03)

THE STRUCTURE OF FINANCIAL SUPERVISION

Approaches and Challenges in a Global Marketplace

THIS REPORT IS EMBARGOED FOR PUBLIC RELEASE AT 10:00 A.M. EST ON MONDAY, OCTOBER 6, 2008.

30 Group of Thirty

Copies of this report are available for $95 from:

The Group of Thirty
1726 M Street, N.W., Suite 200
Washington, D.C. 20036
Tel: (202) 331-2472 Fax: (202) 785-9423

www.group30.org   email:info@group30.org

THE STRUCTURE OF FINANCIAL SUPERVISION

Approaches and Challenges in a Global Marketplace

Group of Thirty

Washington, DC

2008

CONTENTS

FIGURES

FOREWORD

In July 2007, the Group of Thirty decided to launch a review of various national supervisory and regulatory approaches and place them within the context of the changing global financial system. The study set out to look at the changes evident in the financial markets and the evolution of the national supervisory architecture at a time when central banks and supervisory agencies have been seeking to improve their supervisory processes in light of the blurring of lines between different financial sectors and businesses.

The review of 17 major national supervisory systems has confirmed that while dealing with similar problems and challenges, such systems are fashioned through a process that includes a myriad of political, cultural, economic, and financial influences.

Despite the many differences from country to country and market to market, the central bankers, supervisors, and government ministries are charged with overseeing financial institutions and dealing with threats to the stability of the financial system. Our review of supervisory structures has drawn out their commonalities and differences, and the challenges faced by those selecting one approach or another.

The Group of Thirty is pleased to present this broad review to the supervisory and regulatory community. It is hoped that this assessment of the various regulatory systems will be of interest to policymakers, and that a consistent presentation of structural details of various systems will help illuminate differences in financial supervisory structures for analysts, journalists, and the officials directly concerned.

Paul A. Volcker
Chairman of the Trustees
The Group of Thirty

Jacob A. Frenkel
Chairman
The Group of Thirty

ACKNOWLEDGMENTS

The Group of Thirty would like to pay tribute to those whose time, talent, and energy have driven this project forward. First, we would like to thank the members of the working group, who committed their time and intellect to bringing this project to fruition.

Special recognition must go to the many supervisory institutions and individuals that provided their views and input during the interviews and the research process. Without their support and collective input the review would not have been possible. Documentary research is useful, but it is no substitute for the personal impressions of senior central bankers, supervisors, and regulators. A full list of the institutions that aided this project is provided in the appendix.

Crafting a cohesive report reflective of many national perspectives and touching a broad array of difficult supervisory and regulatory approaches requires considerable knowledge of the issues and is never easy, but the task was achieved through the hard work and careful prose of Annette Nazareth, who served as Rapporteur of the report. The Group of Thirty thanks Annette for her efforts. We also acknowledge the efforts of Alastair Clark for his assistance in the early stages of the study.

We would also like to thank Don Ogilvie and Rich Spillenkothen of Deloitte & Touche LLP and the Deloitte Center for Banking Solutions and their team, including especially Julia Kirby and Jeanne-marie Smith for their commitment and contributions to the project. Deloitte & Touche provided assistance in reviewing the 17 national supervisory systems and in documenting the results for use in the report.

Thanks to our editor, Diane Stamm, and our designers, Sarah McPhie and Katie Burgess, for their dedicated efforts and flexibility when working on this project.

Finally, the coordination of this project, the many aspects of report production, and the allocation and organization of different responsibilities had their logistical center at the offices of the Group of Thirty. This project could not have been completed without the efforts of Stuart Mackintosh, Sviatlana Francis, and Nicole Firment of the Group of Thirty.

FINANCIAL REGULATORY SYSTEMS WORKING GROUP

Chairman

Paul A. Volcker
Former Chairman, Board of
Governors of the
Federal Reserve System

Vice Chairman

Roger W. Ferguson, Jr.
TIAA-CREF

Members

Jacob A. Frenkel
American International Group, Inc.

Geoffrey Bell
Geoffrey Bell & Company

E. Gerald Corrigan
Goldman Sachs & Co.

Andrew Crockett
JPMorgan Chase International

Jacques de Larosière
BNP Paribas

Richard Debs
Morgan Stanley & Co.

Arminio Fraga Neto
Gavea Investimentos

Gerd Häusler
Lazard International

John Heimann
Financial Stability Institute

Stuart P.M. Mackintosh
Group of Thirty

Observers

Jaime Caruana
International Monetary Fund

Terrence Checki
Federal Reserve Bank of New York

Daniel Hofmann
Zurich Financial Services

Don Ogilvie
Deloitte Center for Banking Solutions

Richard Spillenkothen
Deloitte & Touche LLP

Rapporteur

Annette Nazareth

EXECUTIVE SUMMARY

The Group of Thirty (G30) commenced a 17-jurisdiction review of financial regulatory approaches in July 2007, prior to the current market turmoil that has impacted many countries around the globe.[1] We began the project at a time when the efficiency and efficacy of financial regulation and supervision were being actively discussed and debated. Today, those issues are even more salient and important for national and international financial supervisors and policymakers as they seek to restore financial stability. This report is being published during a period of extensive global focus on the benefits and challenges of various supervisory approaches. We hope it will contribute to the international dialogue on the key matter of supervisory architecture.

The last 25 years have been a period of enormous transformation in the financial services sector. The marketplace has seen a marked shift from domestic firms engaged in distinct banking, securities, and insurance businesses to more integrated financial services conglomerates offering a broad range of financial products across the globe. These fundamental changes in the nature of the financial service markets around the world have exposed the shortcomings of financial regulatory models, some of which have not been adapted to the changes in business structures. These developments require central banks, supervisors, and finance ministries to assess the efficacy of the particular supervisory structures in place in their home countries or jurisdictions. They also call for careful assessment of their approaches to financial crisis management, and the extent to which current structures (national and international) are effective in dealing with the collapse of a systemically important global financial institution.

The G30 report reviews the financial regulatory approaches of 17 jurisdictions in order to illustrate the implications of adopting one or another of the four principle models of supervisory oversight. The review comprises documentary research, supplemented with interviews of central bank governors and supervisors in each jurisdiction, and includes a cross-section of developed economies and emerging markets. The study demonstrates the commonality of the challenges faced by supervisors around the globe, and illuminates the many different structural solutions adopted by supervisors addressing these common challenges within their own particular economic, political, and cultural contexts.

The Four Approaches to Supervision

The report assesses the four approaches to financial supervision currently employed across the globe (Institutional, Functional, Integrated, and Twin Peaks; see table on the following page). It describes the key design issues of each supervisory model, illustrates how each has been implemented in practice, and assesses the strengths and weaknesses of each approach.

[1] The jurisdictions reviewed are Australia, Brazil, Canada, China, France, Germany, Hong Kong, Italy, Japan, Mexico, the Netherlands, Qatar, Singapore, Spain, Switzerland, the United Kingdom, and the United States.

Institutional Approach	The Institutional Approach is one in which a firm's legal status (for example, a bank, broker-dealer, or insurance company) determines which regulator is tasked with overseeing its activity from both a safety and soundness and a business conduct perspective.
Functional Approach	The Functional Approach is one in which supervisory oversight is determined by the business that is being transacted by the entity, without regard to its legal status. Each type of business may have its own functional regulator.
Integrated Approach	The Integrated Approach is one in which a single universal regulator conducts both safety and soundness oversight and conduct-of-business regulation for all the sectors of financial services business.
Twin Peaks Approach	The Twin Peaks approach, a form of regulation by objective, is one in which there is a separation of regulatory functions between two regulators: one that performs the safety and soundness supervision function and the other that focuses on conduct-of-business regulation.

We found that all policymakers and regulators interviewed underscored the critical importance of regulatory frameworks accommodating and keeping pace with dramatic changes and innovation in financial markets. As financial markets and institutions evolve, so too must the regulatory systems that oversee them.

Of course, the design of national supervisory architecture rarely, if ever, takes place with policymakers proceeding from a blank slate. Instead, regulatory structures evolve as a result of particular national debates, events, and economic crises that may prompt a reappraisal of existing frameworks, much like what can be seen to be unfolding in the United Kingdom and the United States.

Many of the jurisdictions that the G30 studied have modified or restructured financial regulatory systems within the last 15 years, and a majority are currently in the process of further restructuring or actively debating the need for significant changes to modernize their systems.

In general, no one model has proven unambiguously superior in achieving all the objectives of regulation. Strong leadership and qualified administrators can offset to some degree the impediments and deficiencies that may stem from suboptimal regulatory structures, but at some point regulatory regimes need to be updated and modernized to accommodate financial evolution, market realities, and global integration.

The report finds a number of structural and design trends evident in the jurisdictions studied.

The Institutional Approach

The traditional or Institutional Approach to supervision is perhaps the model under the most strain, given the changes in financial markets and players, and the blurring of product lines across sectors. Agencies using the Institutional Approach to supervision can overcome its shortcomings via various coordination mechanisms, but the structure is suboptimal, given the evolution of the markets we have witnessed. The jurisdictions reviewed that use the Institutional Approach are China, Hong Kong, and Mexico.

The Functional Approach

The Functional Approach to supervision remains quite common and appears to work well, so long as coordination among agencies is achieved and maintained. However, there is a general awareness that this may be a somewhat suboptimal structure. Because of this, a number of jurisdictions are moving away from the Functional Approach toward twin peaks or integrated systems. The jurisdictions reviewed that use the Functional Approach are Brazil, France, Italy, and Spain.

The Integrated Approach

The report finds some support for the use of an Integrated Approach to supervision. This approach can be effective and efficient in smaller markets, where oversight of the broad spectrum of financial services can be successfully conducted by one regulator. It has also been adopted in larger, complex markets where it is viewed as a flexible and streamlined approach to regulation. The Integrated Approach has the advantage of a unified focus on regulation and supervision without confusion or conflict over jurisdictional lines that can occur under both the Institutional and Functional Approaches. While the Integrated Approach has the effect of eliminating the redundancies that occur under the Institutional and Functional Approaches, some observers believe it may create the risk of a single point of regulatory failure. The challenges of coordination among supervisors in times of disturbance appear to be evident even under the Integrated Approach, in which regulation is consolidated into a single entity responsible for all sectors of the financial industry. The jurisdictions reviewed that use this approach are Canada, Germany, Japan, Qatar, Singapore, Switzerland, and the United Kingdom.

The Twin Peaks Approach

There is a growing interest in and support for “regulation by objective” of the Twin Peaks Approach to supervision. The Twin Peaks Approach is designed to garner many of the benefits and efficiencies of the Integrated Approach, while at the same time addressing the inherent conflicts that may arise from time to time between the objectives of safety and soundness regulation and consumer protection and transparency. When prudential concerns appear to conflict with consumer protection issues, the prudential supervisor in the twin peaks system may give precedence to safety and soundness mandates, because these are closely intertwined with financial stability. The Twin Peaks Approach may help to force a resolution to this conflict. The two jurisdictions that use the Twin Peaks Approach are Australia and the Netherlands. A number of other jurisdictions are engaged in debates over adopting this type of approach. These include France, Italy, Spain, and the United States.

The Exception—The United States

As much as any jurisdiction reviewed, the United States is a prime example of the role that historical precedent, politics, and culture have played in the regulatory structure. The current structure is quite complex and has come under increased scrutiny. The U.S. structure is functional with institutional aspects, with the added complexity of a number of state-level agencies and actors. Historically, it had been viewed as generally effective in meeting the various goals of financial supervision. But today structural reform is more likely to be on the policymaking calendar, in large part because of weaknesses exposed during the 2007–2008 credit crunch and related financial institution failures. The March 2008 U.S. Treasury "Blueprint of a Modernized Financial Regulatory Structure" recognizes the current weaknesses and advocates a modified Twin Peaks Approach as a long-term goal.

The Importance of Domestic Coordination and Communication

Whatever the approach to financial supervision of a particular jurisdiction, any system must strive to have effective coordination among supervisory agencies, central banks, and finance ministries.

Agencies should seek to maintain good contacts and interaction at the operational levels and the principal level. Coordination and communication can and do create challenges, even in jurisdictions that have an integrated regulator, although, other things being equal, the challenges are often greater when there are a larger number of regulatory agencies.

To facilitate coordination, most jurisdictions create special coordinating bodies. Such a coordinating body, often called a Financial Stability Committee, can comprise the heads or senior officials of the regulatory agencies, the central bank, and the finance ministry. This type of institution can prove useful in normal times, and especially important during times of crisis, when the linkages and lines of communication already in place can be activated without delay. This type of structure is often underpinned by Memoranda of Understanding (MOUs) among various agencies and can be supplemented by cross-membership of boards by principals in the agencies. Such structures aimed at facilitating coordination and information sharing are important, but many of them have yet to be tested by the collapse of a systemically important financial institution.

The Role of the Central Bank

Irrespective of the structure of supervision, central banks emphasize the critical importance of having information about and a direct relationship with large, systemically important financial institutions. Supervisors typically stress the importance of communication and coordination with the central bank and the bank's involvement in crisis management, in particular. Some jurisdictions retain a prudential supervisory function for the central bank (for example, Brazil, France, Hong Kong, Italy, Singapore, Spain, the Netherlands, and the United States), while others do not (for example, Australia, Canada, China, Japan, Mexico, Qatar, Switzerland, and the United Kingdom).

Regardless of the particular structure adopted, if information-sharing and decision-making linkages between the central bank and other agencies are inadequate, this can have a serious negative impact on coordination in times of financial crisis, precisely when effective collaboration is most required.

The Importance of Deposit Protection Schemes

Many of those interviewed stressed the importance of an effective, transparent, and efficient deposit protection scheme as a part of a modern financial regulatory architecture. For supervisors grappling with maintaining confidence in the financial system, a well-understood deposit protection scheme is an important part of a national supervisory and regulatory structure. All systems reviewed in the G30 report either have a deposit protection scheme in place or are planning to implement one. Any regime must be structured in such a way as to ensure that depositors' funds can be accessed promptly. In the absence of confidence that they will have ready access to their funds, depositors will have a strong incentive to join a bank run and withdraw their deposits.

The Structure of International Cooperation

A number of supervisors interviewed expressed concern that the international architecture of supervisory coordination and communication has not kept up with the changes in the nature and structure of the global financial marketplace. Supervisors worry that the current ad hoc international coordination system may not be able to handle the failure of a systemically important global financial firm and the concomitant tremors such an event would send around the world.

The current international coordinating bodies involved in encouraging common standards and the exchanges of information cannot be expected to act as the entity for managing emerging financial crises, although they can and do provide an important analytical resource ex post facto. These organizations are generally established along institutional lines (banking, securities, insurance), and as such cannot fully reflect the changing nature of the global financial services marketplace.

In part to deal with that eventuality, a majority of supervisors recognize the value of supervisory colleges for systemically important global financial institutions as fora to build linkages among agencies in normal times, and which play a critically important role in periods of crisis. Many supervisors also believe that flexibility in the procedures and operations of these colleges is critical to their success going forward.

Conclusion

Substantive issues of the design and performance of financial markets are important when considering supervisory and regulatory reforms. Central bankers, supervisors, and ministries of finance must ensure that important public policy goals continue to be achieved in a dynamic global marketplace as supervisors look to update and alter the regulatory architecture. We hope the G30 review of the financial supervisory approaches of 17 selected jurisdictions helps extend the general understanding of the complex issues at stake when deciding to adopt one approach or another and when considering administrative reforms.

PART I: ANALYSIS

Introduction

As financial market turmoil spreads across the globe, regulators, supervisors, policymakers, and the public at large have been questioning the effectiveness of financial supervision and whether changes to existing supervisory models are needed. Such a reassessment process is not a new phenomenon. History has shown that financial market disruptions have often been followed by regulatory reforms. Some of these reforms were incremental, with targeted changes made to existing oversight regimes. Others, however, involved wholesale adoption of very different regulatory approaches. All reforms shared a common goal: to regulate and supervise the financial markets and institutions in an optimal manner. Even in the absence of a financial crisis or market failure, general concerns over the costs and burdens of regulation, and structural inefficiencies and their potential impact on competition, have similarly called into question the advantages and disadvantages of various financial supervisory models.[2] The Group of Thirty is publishing this Report during a period of extensive global focus on the benefits and challenges of various supervisory approaches in order to contribute to the international dialogue on this very important issue.[3]

History has shown that financial market disruptions have often been followed by regulatory reforms.

This report assesses the four basic models of financial supervision currently employed across the globe (Institutional, Functional, Integrated, and Twin Peaks Approaches). After a background discussion that provides historical context in terms of market developments and institutional changes over the last two decades, we describe in detail key design issues of each supervisory model and illustrate how each has been implemented in practice. We assess the strengths and weaknesses of each supervisory approach. We then analyze and discuss how coordination and cooperation among relevant governmental bodies are achieved domestically under each supervisory approach. Special attention is directed to the role of the central bank and the procedures in place for handling financial crises. Further, we examine methods for international regulatory cooperation and coordination. Finally, we briefly make concluding observations and consider other challenges beyond regulatory structure that may warrant further policy consideration.

The financial regulatory approaches of 17 selected jurisdictions are examined to illustrate the implications of adopting one of the four principle models of regulatory oversight.[4] These jurisdictions include a cross-section of developed economies and emerging markets. The second part of this Report contains a summary, or "profile,"

---

[2] "Sustaining New York's and the U.S.' Global Financial Services Leadership," McKinsey & Co., January 2007 (www.nyc.gov/html/om/pdf/ny_report_final.pdf).

"Commission on the Regulation of U.S. Capital Markets in the 21st Century – Report and Recommendations," U.S. Chamber of Commerce, March 2007 (http://www.uschamber.com/publications/reports/0703capmarketscomm.htm); and

"The Competitive Position of the U.S. Public Equity Market," Committee on Capital Markets Research, December 2007 (www.capmktsreg.org/pdfs/The_Competitive_Position_of_the_US_Public_Equity_Market.pdf).

[3] References to regulation and supervision will be used interchangeably in this report since most oversight bodies have the authority to both regulate and supervise. Regulation generally refers to the issuance of rules by an authoritative body, while supervision refers to the oversight of an entity through the application of rules.

[4] The jurisdictions reviewed were Australia, Brazil, Canada, China, France, Germany, Hong Kong, Italy, Japan, Mexico, the Netherlands, Qatar, Singapore, Spain, Switzerland, the United Kingdom, and the United States.

of the financial regulatory structure for each jurisdiction. Each profile provides a general description of and a historical background to the current regulatory system in the jurisdiction. It also cites notable nonstatutory elements of the financial regulatory system and describes the regulatory structure, enforcement procedures, the framework for coordination, international considerations, and current structural regulatory issues. Information contained in the profiles was derived from interviews with the relevant authorities in each jurisdiction and from other internationally recognized organizations such as the World Bank, the International Monetary Fund (IMF), the Bank for International Settlements (BIS), the International Organization of Securities Commissions (IOSCO), the International Association of Insurance Supervisors (IAIS), and the Financial Stability Forum (FSF).

The Group of Thirty conducted interviews with key officials in the relevant jurisdictions, and with practitioners, regulated parties, and those who may have been involved historically in the development of the current regulatory arrangements. These interviews provided invaluable insights into how the regulatory system has been implemented in practice and the perceived strengths and weaknesses of each model.

Background

The past 25 years have been a period of enormous transformation in the financial services sector. The marketplace has seen a marked shift from domestic firms engaged in distinct banking, securities, and insurance businesses to more integrated financial services conglomerates offering a broad range of financial products across the globe. The traditional demarcations among the products and services offered by banks, insurance companies, and securities firms have substantially blurred, as each has sought to maximize profits through business expansion and financial innovation. The days when banks primarily took deposits and made loans, investment banking firms engaged in a narrow range of securities businesses such as underwriting, brokerage and trading, and advisory work, and insurance companies only issued property and casualty or life policies are long past. Today, each of these sectors engages in new businesses that offer complex and sophisticated products, many notable for their high degree of imbedded leverage and often demonstrating characteristics of insurance, banking, and securities offerings. This financial innovation enhanced the profitability of the financial sector for a period of time, but it has also created significant challenges in managing the risks of these cutting-edge products.

> The traditional demarcations among the products and services offered by banks, insurance companies, and securities firms have substantially blurred.

Derivatives are one example of a product type that has clearly altered the financial landscape over the past 25 years. Year-end 1989 figures compiled by the International Swap Dealers Association (ISDA) indicate that transactions in interest rate swaps, currency swaps, and interest rate options were \$2.474 trillion in notional value. By year-end 2007, this figure was \$382.3 trillion.[5] Banks and securities firms are the primary dealers in these markets.

[5] ISDA Market Review (available at www.isda.org/statistics/pdf/ISDA-Market-Review-historical-data.pdf).

There has also been explosive growth in the credit default swaps market. When ISDA first began surveying this activity at year-end 2001, the total outstanding notional amount of credit default swaps was $918.9 billion. By year-end 2007, it was $62.2 trillion—a growth of nearly 37 percent in the second half of 2007 alone.[6]

Securitization products, which are structured to finance assets such as mortgages, credit card receivables, and auto loans, became enormous businesses for financial services firms during this period. Asset-backed securitizations, mortgage-backed securitizations, collateralized loan obligations, collateralized debt obligations, and other structured products came to represent an ever-larger portion of the credit business. Particularly over the past several years, when interest rates were relatively low, the securitization business fueled the market by providing increasingly esoteric products that satisfied the aggressive appetite for higher-yielding securities. Unfortunately, it is now apparent that there were serious flaws in the creation of some of these products, including inadequate mortgage underwriting practices and insufficient historical data, contributing to overly optimistic financial modeling used by the firms that structured these products, and by the credit rating agencies that rated them. It also appears that increased reliance was placed on credit rating agencies and that independent credit analysis by many market participants was severely wanting. Since most of the origination and distribution of these debt products was through investment banks, a material portion of credit market activity now occurs outside of the traditional banking system. This has made the task of supervising credit market activity more difficult for regulators, particularly in jurisdictions that bifurcate banking and securities oversight.

A number of large, systemically important institutions have emerged in many national markets during this period. Indeed, these entities are sufficiently large and integral to the marketplace to raise "too big to fail" or even "too interconnected to fail" concerns among regulators. For example, in 2007 the consolidated assets of seven of the largest U.S. banks and securities firms each exceeded $750 billion, and the two U.S.-government sponsored mortgage giants, Fannie Mae and Freddie Mac, had consolidated assets exceeding $882 billion and $794 billion, respectively.[7] In the second quarter of 2008, 24 global banks and investment banks each reported total assets exceeding $1 trillion.[8]

Today there are also a number of major market participants that are unregulated. Private equity firms and hedge funds represent an increasing percentage of financial markets activity, but they have generally not been subject to direct supervisory oversight. While conceptually the participation of these new entrants has benefitted the marketplace by fostering pricing efficiencies and risk dispersion, the relative opacity of their activities raises concerns. For the most part, regulatory oversight of these entities has been indirect, via the oversight of regulatory counterparts with which they conduct their business.

As indicated, many financial products today have elements of banking, insurance, and securities products. Yet in many

---

6 Ibid.

7 SEC Form 10-K for fiscal year ended 2007 for Goldman Sachs, Merrill Lynch, Bank of America, Citigroup, JPMorgan Chase, Wachovia, Fannie Mae, and Freddie Mac (available at www.sec.gov/edgar/searchedgar/webusers/htm).

8 Balance Sheet charts, Bloomberg, Second quarter, 2008.

jurisdictions these entities are subject to disparate regulation that reflects the distinct business models of a bygone era. Several jurisdictions that have reformed their regulatory structures have done so in order to better reflect this new business reality. Those that have not done so seek to manage the challenges of jurisdictional overlaps and regulatory arbitrages caused by the historical disparities in regulatory approaches.

There has also been explosive growth in the globalization of the financial services sector over the last two decades as technology has enabled a virtually borderless marketplace. While some regulatory impediments still exist, on the whole the ability to transact business across borders is relatively seamless. By 2007, for example, three major U.S. investment banks derived nearly 50 percent of their net revenues from offshore activity.[9] Large global financial institutions play a significant role in many national markets.

Foreign securities holdings by U.S. investors nearly doubled from $3.1 trillion to $6.0 trillion between 2003 and 2006, evidencing a marked increase in cross-border activity.[10] Indeed, today nearly two-thirds of all American investors have investments in non-U.S. companies.[10] While these statistics highlight the global nature of trading and investment and the interconnectedness of the markets, they also auger growing opportunities for contagion, because a problem in one part of the globe can easily make its way to another. Systemic problems in the financial system continue to be highly contagious today. The fact that recent disruption in the collateralized debt obligation market due to subprime mortgage issues in the United States has had cross-border consequences in Germany, for example, provides ample proof of this exposure.

Systemic problems in the financial system continue to be highly contagious today.

These developments have exposed the shortcomings of financial regulatory models, some of which have not been updated to reflect new business realities. They also highlight the importance of information sharing and international cooperation by regulators, because financial crises can circle the globe with alarming speed. Ultimately, these developments also point to the need for convergence to high-quality, internationally recognized regulatory standards, including international accounting standards, for example. In such an interconnected financial landscape, key protections must be generally accepted and implemented in all major market centers. To do otherwise would risk business migration to less-regulated jurisdictions, ultimately posing a threat to the stability of the financial system.

The Policy Goals of Regulation

It is commonly understood that financial regulation should be designed to achieve certain key policy goals, including: (a) safety and soundness of financial institutions, (b) mitigation of systemic risk,

[9] See SEC Form 10-K for fiscal year ended 2007 for Goldman Sachs, Lehman Brothers, and Morgan Stanley (available at www.sec.gov/edgar/searchedgar/webusers.htm).

[10] "Report on U.S. Portfolio Holdings of Foreign Securities as of December 31, 2006," by Department of the Treasury, the Federal Reserve Bank of New York, and the Board of Governors of the Federal Reserve System, November 2007 (www.ustreas.gov/tic/shc2006r.pdf).

[11] "Equity Ownership in America," by the Investment Company Institute and Securities Industry Association (now the Securities Industry and Financial Markets Association [SIFMA], 2005, page 23) (www.sifma.org/research/reviews/Reviews.html).

(c) fairness and efficiency of markets, and (d) the protection of customers and investors. These broad goals, while clearly important, do not take into account an additional factor that has come to be regarded as critical in any well-functioning regulatory system; namely, minimum regulatory burden through efficiency and cost-effectiveness. It is fair to say that each of the four models of financial supervision is designed to achieve the policy goals of regulation, albeit in different ways. The differences in the models may be more acute when viewed through the prism of regulatory burden, that is, efficiency and cost-effectiveness.

Each of the four policy goals is described in greater detail below.

A. Safety and Soundness of Financial Institutions

Effective regulation should be designed to promote the safety and soundness of individual financial institutions. Regulatory oversight that focuses on the solvency of institutions and the protection of customer assets is critical to a well-functioning financial system. Traditionally, banks and insurance companies have been regulated through a combination of rules and prudential examinations and supervision. Protection of an institution and its capital base was of paramount concern. For securities firms, at least in jurisdictions such as the United States, the regulatory approach has involved more rules-based enforcement, with prescriptive rules relating to capital requirements, customer protection, and business conduct. The primary focus of securities regulators traditionally has been on customer protection, with the safety and soundness of the institution being one means of furthering that goal. Safety and soundness regulation involves a mixture of proscriptive rules and more prudential review and appraisal, with an emphasis on persuasion rather than through enforcement action involving fines, penalties, or other sanctions.

Effective regulation should be designed to promote the safety and soundness of individual financial institutions.

B. Mitigation of Systemic Risk

An overarching goal of financial supervision is to monitor the overall functioning of the financial system as a whole and to mitigate systemic risk. For some regulators, this goal is statutorily mandated; for others, it is implicitly understood and adopted. This would seem to be the most incontrovertible goal, and the most challenging to achieve. Financial systems cannot function effectively without confidence in the markets and financial institutions. A major disruption to the financial system can reduce confidence in the ability of markets to function, impair the availability of credit and equity, and adversely impact real economic activity.

Systemic risk generally refers to impairment of the overall functioning of the system caused by the breakdown of one or more of the key market components. Systemically important players would include, among others, large, multinational banks, hedge funds, securities firms, and insurance companies. In addition, there are systemically important markets and infrastructures, in particular, the payments and clearance and settlement systems.

C. Fairness and Efficiency of Markets

Well-functioning markets are characterized by efficient pricing, which is achieved through market rules concerning the wide availability of pricing information and prohibitions against insider trading and anticompetitive behavior. They require transparency of all material information to investors. Regulatory schemes further these goals by mandating disclosure of key information, whether it is about business and financial performance, about the prices at which securities are bought or sold, or other key information that is important to investors. Disclosure permits market participants to make optimal decisions with complete information. These transparency goals may conflict with the interests of a particular institution at any point in time, and thus they may be contrary to other goals of regulation, such as maintenance of safety and soundness and market continuity. For example, a financial institution that is experiencing liquidity issues may want to keep that information private in order to minimize speculation that could disrupt efforts to work out its problems. At the same time, investors in the institution would want the most timely and accurate information in order to make an investment decision. They also have an expectation that the market prices for an institution's stock reflect the disclosure of all material information. These divergent considerations may lead to disparate responses by different regulators and locations.

D. Protection of Customers and Investors

Financial regulation is also designed to protect customers and investors through business conduct rules. Particularly in cases where transparency requirements alone are insufficient, investors are protected by rules that mandate fair treatment and high standards of business conduct by intermediaries. Conduct-of-business rules ultimately lead to greater confidence in the financial system and therefore potentially greater market participation. Business conduct regulation has a quite different focus from safety and soundness oversight. Its emphasis is on transparency, disclosure, suitability, and investor protection. It is designed to ensure fair dealing. Such standards have been widely adopted in securities regulation for several decades. The sale of risk products to individuals traditionally was viewed as an appropriate area for substantive conduct regulation. Classic examples of business conduct rules include conflict-of-interest rules, advertising restrictions, and suitability standards. Some observers claim that business conduct rules per se were less common in the banking sector, although fiduciary principles applied. As banks have ventured further from their original business models and have become more active purveyors of risk-based products and services, particularly to retail customers, banking regulators are applying business conduct restrictions more broadly.

The Four Approaches to Financial Supervision

While no two jurisdictions regulate financial institutions and markets in exactly the same manner, the current models of financial supervision adopted worldwide can, as already noted, be divided into four categories: (a) the Institutional Approach, (b) the Functional Approach, (c) the Integrated Approach, and (d) the Twin Peaks Approach. No "pure" example of any model may actually exist, and blurring between approaches is prevalent. The specific way in which regulation and supervision has been structured in each jurisdiction reflects, among other things, its unique history, politics, culture, size, economic development, and local business structure.

...each jurisdiction reflects, among other things, its unique history, politics, culture, size, economic development...

Likewise, the effectiveness of the model in any particular jurisdiction may be influenced by uniquely local factors, so that no single model may be optimal on a "one size fits all" basis for all jurisdictions.

1. The Institutional Approach

The Institutional Approach is one of the classical forms of financial regulatory oversight. It is a legal-entity-driven approach. The firm's legal status (for example, an entity registered as a bank, a broker-dealer, or an insurance company) essentially determines which regulator is tasked with overseeing its activity both from a safety and soundness and a business conduct perspective. This legal status also determines the scope of the entity's permissible business activities, although generally there has been a tendency for the regulators to reinterpret and expand the scope of permissible activities, and therefore the scope of activities under their jurisdiction, when requested to do so by the firms. Thus, over time, entities with different legal status have been permitted to engage in the same or comparable activity and be subject to disparate regulation by different regulators.

2. The Functional Approach

Under the Functional Approach, supervisory oversight is determined by the business that is being transacted by the entity, without regard to its legal status. Each type of business may have its own functional regulator. For example, under a "pure" Functional Approach, if a single entity were engaged in multiple businesses that included banking, securities, and insurance activities, each of those distinct lines of business would be overseen by a separate, "functional" regulator. The functional regulator would be responsible for both safety and soundness oversight of the entity and business conduct regulation. The challenge for the Functional Approach is that activities must fall into categories clear enough for the regulator to oversee.

3. The Integrated Approach

Under the Integrated Approach, there is a single universal regulator that conducts both safety and soundness oversight and conduct-of-business regulation for all the sectors of the financial services business. This model has gained increased popularity over the past decade. It is sometimes referred to as the "FSA model" because the most visible and complete manifestation is the Financial Services Authority (FSA) in the United Kingdom.

4. The Twin Peaks Approach

The Twin Peaks Approach is based on the principle of regulation by objective and refers to a separation of regulatory functions between two regulators: one that performs the safety and soundness supervision function and the other that focuses on conduct-of- business regulation. Under this approach, there is also generally a split between wholesale and retail activity and oversight of retail activity by the conduct-of-business regulator. This is also viewed by some as supervision by objective.

Selected Examples of Each Model of Financial Supervision

Selected jurisdictions from those we reviewed are highlighted here to illustrate examples of each of the four models of financial supervision.

The Institutional Approach—China and Mexico

It is often difficult to clearly distinguish those jurisdictions that employ an Institutional Approach from those that have implemented a Functional Approach. This lack of clarity is understandable if one considers that when an institution is permitted by its regulators to expand into new business lines within an existing entity, the Institutional and Functional Approaches become difficult to distinguish. Indeed, the terms were sometimes used interchangeably by officials when describing the same national models. Nevertheless, two jurisdictions highlighted in the profiles that may best illustrate the Institutional Approach are China and Mexico.

China

China operates under an Institutional Approach, with some elements of functional supervision. While most jurisdictions that have implemented reforms in the past 25 years have tended to move toward an Integrated Approach or a Twin Peaks Approach, China did not. Under the previous regulatory structure, all financial supervision was consolidated within the People's Bank of China, which is China's central bank. Through a series of reforms over the past 25 years, China has moved to an Institutional Approach, where the banking, securities, and insurance sectors are supervised by separate agencies.

Since 1998, the China Securities Regulatory Commission (CSRC) has been the agency responsible for supervising and regulating the securities and futures sector. It is responsible for listed companies, securities firms, and markets. It focuses on protecting medium and small investors. Also in 1998, the China Insurance Regulatory Commission (CIRC) was formed to oversee the insurance industry. In 2003, the primary responsibility for supervision and regulation of the banking sector was moved from the People's Bank of China to the new China Banking Regulatory Commission (CBRC), whose responsibilities include banks, financial asset management companies, trust and investment companies, and other depositary financial institutions. Its responsibilities include approving new banking institutions, formulating prudential rules and regulations, and conducting examinations.

The People's Bank of China's role is now limited to formulating and implementing monetary policies and maintaining financial stability. It nevertheless retains a role in policy formulation. Specifically, the Governor of the People's Bank of China is a member of the State Council of China, the government's executive body. As such, he has considerable continuing influence over the general direction of financial reforms, particularly when the issues are debated by and decided on by the State Council.

Given the evolution of financial markets, the Institutional Approach in China is facing the need to accommodate marketplace changes as the financial services industry becomes increasingly integrated and the lines between traditional banking, securities, and insurance businesses become blurred. Through holding companies, banks and other institutions have begun to offer products outside their traditional areas of activity, thus creating issues of supervisory prerogative. For example, questions arise when an insurance company offers a traditional banking product. Should the product be regulated by the CIRC or the CBRC? Issues such as this arise with increasing frequency as the product and services offered by banks, securities firms, and insurance companies become more similar. This puts greater pressure on supervisors to coordinate before they act. The Chinese authorities believe that their efforts at coordination generally have been successful.

Mexico

Mexico is another jurisdiction whose regulatory structure employs primarily an Institutional Approach. The Mexicans refer to their structure of regulation and supervision as a "silo" approach. Three government agencies are in charge of regulation and supervision of financial entities: the National Banking and Securities Commission (CNBV), the National Insurance and Bond Companies Commission (CNSF), and the National Commission for the Retirement Savings System (CONSAR). There is no consolidated supervision and no lead supervisor of financial groups. Another government agency, the National Commission for the Protection of Financial Services Users (CONDUSEF), is in charge of consumer protection, and the Deposit Insurance Agency (IPAB) administers deposit insurance.

CNBV is the principal supervisory entity. It regulates both banking institutions and brokerage firms. In 1995, the predecessor banking and securities commissions were merged due to the realization that most banking institutions and brokerage firms operated under common holding companies within newly formed financial groups. CNBV's main objectives are safety and soundness regulation and supervision of all financial intermediaries (except for insurance, bond companies, and pension funds). It also regulates securities and exchange-traded derivatives. CNBV's Board of Governors has representatives of other arms of the government, including members from the Ministry of Finance, the Bank of Mexico, CNSF, and CONSAR.

The Bank of Mexico, the central bank, does not directly regulate or supervise financial entities, although it may propose regulation if it views existing regulation as insufficient. The Bank of Mexico has four main objectives: to provide the country's economy with domestic currency; to promote price stability; and to promote the sound development of the financial system and the proper functioning of the payment systems. It is the lender of last resort.

The regulatory structure within Mexico has been a subject of debate since the mid-1990s. Even after the merger of the securities and the banking commissions, consideration was given to merging all existing supervisory commissions. There was also a recognition that a specialized body was needed to focus on consumer protection in the financial services arena. Debates over reforms to the regulatory structure in Mexico are centered more on improving the efficiency of the existing model, and increasing the population's access to a broad range of financial services.

In addition to China and Mexico, Hong Kong's[12] regulatory model is also best described as the Institutional Approach.

The Functional Approach—Italy and France

Two jurisdictions that perhaps best illustrate the Functional Approach to financial regulatory oversight are Italy and France.

Italy

In Italy, financial regulation is organized along functional lines. Financial services activities are divided among four main

[12] On July 1, 1997, Hong Kong became a Special Administrative Region of the People's Republic of China (HKSAR). In this profile, HKSAR refers to Hong Kong.

activities: banking, investment services, asset management, and insurance. Each industry has its own supervisor, legal framework, and rules.

The Bank of Italy, the central bank, has a monetary policy role as part of the European System of Central Banks, and has supervisory and regulatory authority over Italian banks. It is a prudential regulator whose focus is on the safety and soundness of the institutions subject to its jurisdiction. In addition to its banking supervision responsibilities, the Bank of Italy focuses on the stability of the financial system. It has a statutory mandate to ensure overall stability, efficiency, and competitiveness of the financial system. The Bank of Italy has rulemaking authority and enforcement powers.

The Companies and Stock Exchange Commission (CONSOB) is the public authority responsible for regulating the securities markets and the provision of investment services. Its mandate includes: (a) transparency of and reviewing business practices by securities market participants; (b) disclosure of complete and accurate information to the investing public by listed companies; (c) accuracy of prospectuses related to share and security offerings to the investing public; and (d) compliance with regulation by auditors. CONSOB also conducts investigations related to insider trading and market manipulation. To the extent CONSOB's focus is principally conduct-of-business oriented, this aspect of Italy's approach to financial oversight incorporates elements of the Twin Peaks Approach.

The supervisor of the insurance sector in Italy is the Insurance Industry Regulatory Authority (ISVAP). ISVAP is responsible for regulating and monitoring the activities of insurance intermediaries. It is also required to perform all activities necessary to promote consumer protection. The Finance Code mandates that the primary purpose of insurance supervision is both the sound and prudent management of the insurance and reinsurance business and the integrity of the insurance market and consumer protection. Thus, ISVAP is a functional regulator of the insurance sector with both safety and soundness and conduct-of-business mandates.

Since 2004, there has been significant debate in Italy regarding the need for further structural reform of the supervisory oversight model. Some of the proposals have been aimed at reducing the number of supervisory authorities in the hope of designing a more efficient regulatory model. Specifically, the debate has focused on whether the number of supervisors should be reduced to two—the Bank of Italy and CONSOB—with a reallocation of the responsibilities of the other financial regulators. Such reform, were it to be adopted, would move Italy closer to a Twin Peaks Approach to regulatory oversight.

France

France also has a regulatory oversight model that can best be described as a Functional Approach, although, like Italy, there is some allocation of functions that closely resembles the Twin Peaks Approach.

Financial services oversight was reformed in France in 2003 with the goal of improving efficiency of the regulatory system. The framework for financial supervision was reorganized and substantially simplified at that time, although it still has many more functional regulatory bodies than many other jurisdictions.

Prudential supervision of both banks and investment firms is the responsibility of the Banking Commission, which is chaired by the Governor of the Bank of France and is located within the central bank. The division of labor between the Banking Commission and the Financial Markets Authority (AMF) resembles that of the Bank of Italy and the CONSOB in Italy, in that the prudential oversight and conduct-of-business responsibilities are split between the banking supervisor and the securities supervisor, respectively.

The Committee of Credit Institutions and Investment Firms (CECEI), also chaired by the Governor of the Bank of France, is responsible for the authorization of credit institutions and investment firms, while the AMF is in charge of the authorization of unit trusts and investment funds.

The Financial Markets Authority (AMF) was established in 2003 to protect the interests of small investors and promote the smooth functioning of financial markets. The AMF monitors securities transactions and collective investment products to ensure compliance with disclosure obligations to the investing public. A representative of the central bank, the Bank of France, sits on the AMF board.

Insurance activities in France are supervised by a separate insurance regulator, the Insurance and Mutual Societies Supervisory Authority (ACAM). Licensing for insurance companies is separated from ACAM in a manner similar to the CECEI and is performed by the Committee on Insurance Companies. To enhance cooperation between the Banking Commission and ACAM, it is statutorily required that the Chairman of ACAM be a member of the Banking Commission, and the Governor of the Bank of France, as Chairman of the Banking Commission, is a member of ACAM.

In addition to Italy and France, other jurisdictions we reviewed that employ a version of the Functional Approach include Brazil, Spain, and, to some extent, the United States.

The Integrated Approach—The United Kingdom and Germany

The United Kingdom

A jurisdiction that exhibits the key facets of the Integrated Approach to regulation is the United Kingdom (U.K.). The impetus for the move to the Integrated Approach was the recognition that major financial firms had developed into more integrated full-service businesses in the U.K. and elsewhere in the 1990s. The historical, more fragmented, or "siloed," approach to regulation was viewed as suboptimal. Thus, in 1997, major reform of financial services regulation was put into effect in the U.K. with the creation of a unified regulator, the Financial Services Authority (FSA).

The FSA regulates and supervises almost all financial services businesses in the U.K., including banking, securities, and insurance, on a prudential basis and as regards conduct-of-business activities. It has four main statutory objectives: to maintain market confidence, to promote public awareness on financial matters, to protect consumers, and to reduce financial crime. Thus, the FSA is responsible for both safety and soundness of financial institutions and conduct-of-business regulation. It is often cited by regulated entities as a model of an efficient and effective regulator, not only because of its streamlined model of regulation, but also because it adheres to a series of "principles of good regulation," which center on efficiency and economy, the role of management, proportionality, innovation, the international character of financial services, and competition.[13] This overlay of pragmatic business principles, in addition to the traditional goals of regulation, has been a distinguishing feature of the U.K. regulatory approach.

The FSA also has broad investigatory, enforcement, and prosecutorial powers. The main area of financial regulation falling outside the FSA's purview is corporate reporting and governance, which is the responsibility of the Financial Reporting Council (FRC). Also, since 1968, takeover bids in the U.K. are overseen by the Takeover Panel.

At the time of the 1997 regulatory reforms, the Bank of England was made independent in the conduct of monetary policy. It was decided, however, that allowing the bank to retain its direct banking supervisory role would unduly concentrate power in the Bank of England. Concerns were raised regarding potential conflicts of interest and priorities between the monetary and regulatory functions and the disparate staffing requirements for the monetary and regulatory roles. The Bank of England contributes to financial stability through its market operations, its oversight of the payments system, and its access to market intelligence. In the U.K., Her Majesty's Treasury is responsible for determining the statutory framework for financial regulation and for determining whether lender-of-last-resort authority should be used.

Recent events such as the run on Northern Rock bank prompted a reappraisal of the Integrated Approach in the U.K. The approach has been generally endorsed and reconfirmed by the government, with some targeted legislative changes proposed to address particular areas, including the deposit insurance scheme, the special resolution regime, and the clarity of roles of the Tripartite Authorities (Her Majesty's Treasury, Bank of England, and FSA) within the Tripartite Agreement. Other observers have been more critical, suggesting that the Integrated Approach and Tripartite Agreement, in particular, failed to ensure a fast-enough reaction to the liquidity crisis and the related Northern Rock bank collapse in the U.K.

Germany

Germany also employs an Integrated Approach to supervisory oversight, although with several distinct differences from the U.K. approach.

Prior to 2002, Germany operated under an Institutional Approach to regulation, with separate federal supervisors for banking, securities, and insurance. Regulators in each state (Land) supervised the stock exchanges. In 2001, the government initiated a reform of the German central bank (the Bundesbank). The government also reconsidered the institutional nature of financial supervision in light of changes in the financial markets. Integration of the financial sector had blurred the boundaries among the financial services activities and resulted in overlapping products, services, and supervisory functions. A single, integrated supervisor was created—the Federal Financial Supervisory Authority (BaFin). The central bank nevertheless retained

[13] www.fsa.gov.uk/Pages/About/Aims/Principles/index.shtml.

a number of important supervisory functions, and thus BaFin coordinates its supervisory functions with the central bank.

BaFin supervises all three traditional financial businesses—banking, securities, and insurance—and aims to ensure the safety and soundness of these institutions. BaFin's insurance supervision aims to safeguard insured parties. Through its market supervision, BaFin enforces standards of professional conduct, which aim to preserve investors' trust in the financial markets. BaFin also has an investor protection role and seeks to prevent unauthorized activities.

In addition to its traditional central bank roles, the Bundesbank exercises some banking supervisory functions. Since there appears to be some overlap in the supervisory responsibilities of the central bank and BaFin, an MOU defines their respective roles in normal day-to-day supervision to avoid duplication of work. Under the MOU, the central bank is allocated most of the operational tasks in banking supervision. It also plays a role in crisis management. It advises the federal government on economic policy issues of major importance.

In contrast to the U.K., insurance supervision in Germany is split between the federal government and the states. BaFin supervises private insurance entities operating in Germany that are of material economic significance, and competitive public-law insurance institutions that operate across the borders of any Land. Each of the Länder's supervisory authority generally applies to those insurance entities whose activities are limited to particular state and private insurance entities of lesser material economic significance.

Supervision of the individual stock exchanges in Germany is the responsibility of the stock exchange supervision authorities of the Länder. They supervise the orderly conduct of trading on exchanges, including monitoring the pricing process. They are also responsible for the registration of electronic trading systems and the supervision of exchange-like trading systems. BaFin coordinates with the stock exchange supervisory authorities in representing the regulators at the international level.

There continue to be internal debates in Germany over refinements to the supervisory approach and the relative responsibilities of BaFin and the central bank. It is noteworthy that the central bank's involvement in banking supervision, and particularly in operational aspects, contrasts with the U.K. The central bank continues to play a role in banking supervision, which is one of its primary areas of expertise. It is not involved in insurance or securities supervision, however. Thus, Germany's supervisory structure remains somewhat bifurcated and does not represent a "pure" Integrated Approach.

In addition to the U.K. and Germany, other jurisdictions featured in the profiles that use the Integrated Approach to financial supervision include Japan, Qatar, and Singapore. Switzerland will adopt the Integrated Approach as of January 1, 2009.

The Twin Peaks Approach—Australia and the Netherlands

In recent years there has been a discernable increase in interest in the Twin Peaks Approach to regulatory supervision and regulation by objective. Two examples of the implementation of that approach are Australia and the Netherlands.

Australia

Since 1997, following a review of its system of financial services regulation, Australia has organized its oversight responsibilities under a Twin Peaks Approach that separates prudential regulatory oversight from conduct-of-business regulation.

The Australian Prudential Regulatory Authority (APRA) regulates deposit-taking institutions, which include banks, building societies, credit unions, and insurance companies and large superannuation (retirement pension) funds. It is independent of the central bank and is a prudential regulator that focuses on the safety and soundness of the entities it supervises. APRA is responsible for dealing with institutions that are unable to meet their obligations, and it does this in close cooperation with the Reserve Bank of Australia (RBA), the Australian central bank, which is available to provide liquidity support if necessary. APRA also has a statutory duty to promote financial system stability in Australia.

The Australian Securities and Investments Commission (ASIC) is the business conduct regulator responsible for market integrity and consumer protection across the financial system in Australia. It regulates companies, financial markets, financial services organizations, and market professionals. It is not a prudential supervisor. It issues guidelines, preferred practices, regulatory guidelines, and codes of conduct. It also has enforcement powers.

The RBA has responsibility for financial stability, interest rates, and payment systems. It is responsible for ensuring that licensed clearance and settlement facilities for securities and derivatives conduct their affairs in a manner consistent with financial stability.

The Netherlands

The Netherlands adopted a Twin Peaks Approach to financial services regulation. Unlike Australia, in the Netherlands the central bank (DNB) also serves as the prudential and systemic risk supervisor of all financial services, including banking, insurance, pension funds, and securities.

The Netherlands Authority for the Financial Markets (AFM) is responsible for all conduct-of-business supervision. Its overall objective is to promote transparent markets and processes and to protect the consumer. The work of the agency is guided by three further objectives: to promote access to the market; to ensure the efficient, fair, and orderly operation of the market; and to guarantee confidence in the market. Both the DNB and the AFM have enforcement authority.

Until the late 1990s, the Netherlands employed the Institutional Approach to financial supervision. Regulators were divided along the traditional lines of banking, insurance, and securities. This model was abandoned in favor of a Twin Peaks Approach due to the consolidation of the Netherlands financial sector into one dominated by companies conducting business across multiple product lines, and the development of complex financial products that have cross-sector elements.

In the Netherlands, the Ministry of Finance serves as the lender of last resort in the event of a potential financial institution failure. The DNB would take the lead in crisis management. Under current arrangements, the AFM would not play an official role in crisis arrangements, although it may be included in a future MOU.

In addition to Australia and the Netherlands, the other jurisdiction we reviewed that is expected to adopt a Twin Peaks Approach in the near future is Spain.

The Exception—The U.S. Model

Given the size and significance of the U.S. market, any description of financial supervision would be incomplete without some mention of the U.S. model of regulation. Perhaps as much as any jurisdiction reviewed, the United States is a prime example of the role that historical precedent, politics, and culture have played in the regulatory structure. U.S. regulation of financial institutions took its present form in the Great Depression of the 1930s, and the structure established at that time largely reflected the siloed structure of the businesses at that time. While the current structure is quite complex and has come under increased scrutiny in recent years, for the most part it has been viewed as effective in meeting the various goals of financial supervision, including promoting safety and soundness of individual financial institutions, market integrity, investor and customer protection, and financial stability. The model can best be described as a Functional Approach, with some institutional elements.

One unique aspect of the U.S. system is its dual nature. Since the earliest days of the government, banks have had the choice of state or federal charters, with choice being viewed as an important source of innovation. With the creation of the Federal Reserve in 1913, state-chartered institutions that were members of the Federal Reserve came under federal supervision.

The events of the stock market crash of 1929 and the Great Depression of the 1930s resulted in a supervisory oversight structure that has lasted for decades. Among other things, commercial banking and investment banking were separated by the *Glass-Steagall Act*. The Securities and Exchange Commission (SEC) was established to regulate the U.S. securities markets, and the Federal Deposit Insurance Commission (FDIC) was put in place to insure deposits and discourage bank runs. Predecessors to the Office of Thrift Supervision (OTS) and the Commodity Futures Trading Commission (CFTC) were established to regulate home loan banks, thrift institutions, and commodity exchange activities.

The *Financial Modernization Act* of 1999, also known as the *Gramm-Leach-Bliley Act* (GLBA), repealed provisions of the *Glass-Steagall Act* that restricted the ability of bank holding companies to affiliate with securities firms and insurance companies. GLBA substantially modernized the U.S. financial services industry, but it made only incremental changes to financial services regulation. As a result, U.S. financial conglomerates can now operate in virtually all areas of financial services, but the regulatory structure remains largely institutional. Attempts to address functional regulation under GLBA, whereby the regulator that is responsible for the activity will supervise that activity, were minimally successful, because the provisions of the Act were subject to numerous exceptions that were highly negotiated in the legislative process and immensely difficult to implement. Indeed, the implementing rules concerning the functional regulation of securities activities of banks took several years to negotiate among the relevant banking and securities supervisors.

Ultimately, banking and securities activities are regulated at both the state and federal levels by multiple regulators. Insurance, on the other hand, is regulated at the state level and futures principally at the federal level. Five federal agencies oversee banking and thrift activities (the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and the National Credit Union Administration), and state and federal banking agencies jointly oversee state-chartered banking institutions and thrifts. Banking regulators employ a prudential regulatory approach, while the Securities and Exchange Commission (SEC) is generally more enforcement oriented.

Several recent studies have focused on the inefficiencies of the U.S. regulatory system and have recommended reforms. Each study has referenced the potential negative impact that this duplicative regulatory structure and the costs associated with it may be having on U.S. competitiveness.[14] The recent rescues of the investment bank Bear Stearns and the government-sponsored enterprises Fannie Mae and Freddie Mac, have also spurred a vigorous public dialogue on the structure and effectiveness of financial regulation in the United States.

An Assessment of the Four Supervisory Approaches

Regardless of the approach to financial supervision adopted in a particular location, all regulators we interviewed expressed confidence in their ability to satisfy their statutory mandates and meet the goals of regulation under their existing regulatory structure. Most have developed pragmatic approaches such as cooperation and information sharing with other relevant supervisors to address any perceived structural inefficiencies in their regulatory models. Those that are in the process of implementing reforms, such as Spain and Switzerland, were optimistic that impending changes to their regulatory models would not only improve their ability to regulate effectively, but would also do so in a more streamlined, efficient, and effective manner.

The United States and the United Kingdom currently stand apart for the intensity of their ongoing efforts to reassess the effectiveness of their regulatory approaches. This is due in no small part to the severity of the financial problems, stresses, and market phenomena that have occurred in both jurisdictions—the winding down and sale of Bear Stearns, the government efforts to reinforce market confidence in the mortgage giants Fannie Mae and Freddie Mac in the U.S., and the run on Northern Rock in the U.K.

> The United States and the United Kingdom currently stand apart for the intensity of their ongoing efforts to reassess the effectiveness of their regulatory approaches.

In its report entitled "Blueprint of a Modernized Financial Regulatory Structure,"[15] issued in March 2008, the U.S. Treasury proposes a major restructuring of financial supervision toward a regulation by objectives approach, in some ways similar to the Twin Peaks Approach to supervision and regulation. In the U.K., both the

[14] "Sustaining New York's and the U.S.' Global Financial Services Leadership," McKinsey & Co., January 2007 (www.nyc.gov/html/om/pdf/ny_report_final.pdf).

"Commission on the Regulation of U.S. Capital Markets in the 21st Century – Report and Recommendations," U.S. Chamber of Commerce, March 2007 (http://www.uschamber.com/publications/reports/0703capmarketscomm.htm);

"The Competitive Position of the U.S. Public Equity Market," Committee on Capital Markets Research, December 2007 (www.capmktsreg.org/pdfs/The_Competitive_Position_of_the_US_Public_Equity_Market.pdf).

[15] www.treas.gov/press/releases/reports/Blueprint.pdf.

financial supervisors and the Parliament appear to support targeted changes to the existing Integrated Approach. In both jurisdictions, the benefits and disadvantages of other regulatory approaches have been actively debated.

Ultimately, of course, the success of any regulatory approach must be measured by the ability of regulators to achieve the policy goals of regulation in real world contexts rather than by simply tallying theoretical pros and cons. Arguably, there is no single optimal approach for all jurisdictions, because each has its own unique issues. That said, there is merit in considering the benefits and disadvantages of each approach in order to assist those who seek to make informed decisions on possible reforms.

The Institutional Approach

The Institutional Approach to supervision is under some stress due to significant changes in financial services business models. The Institutional Approach is based on a business model that, to a large extent, no longer exists. Many large financial firms are involved in a cross-section of products and services rather than in the monoline activities of the past. Indeed, they tend to operate along business lines without regard to legal status of the entities in which the activity is technically situated or recorded for regulatory purposes.

> The Institutional Approach is based on a business model that, to a large extent, no longer exists.

The Institutional Approach suffers from potential inconsistency in the application of rules and regulations by disparate regulators and the challenges associated with interagency coordination. Because the same or economically similar activity may be conducted by entities that are legally authorized and overseen as banks, insurance companies, or securities firms, the separate institutional regulators may regulate the activity differently. This different regulatory treatment may take the form of different capital treatment or customer protection rules, for example.

In practical terms, the Institutional Approach may be the most difficult to maintain given how much financial services firms and products have evolved from their institutional labels—banking, insurance, and securities. As regulators expand the scope of business that is permissible in a regulated legal entity, that activity will likely overlap with the regulatory purview of another supervisor. At its most extreme, this can result in regulators overseeing virtually identical conduct under potentially different rules. In practice, it has in at least some cases moved the regulators to adopt some functional elements of supervision where there are clear overlaps in product offerings. This appears to be occurring, for example, in China. As cross-sector business has expanded in China, questions of supervisory prerogative have arisen. Agencies are working to strengthen the coordination among their activities involving cross-sector products in order to reach agreement on regulatory actions before approvals are granted.

The Institutional Approach potentially suffers from not having a single regulator with a 360-degree overview of a regulated entity's business or of the market as a whole. It also suffers from not having a single regulator that can mandate actions designed to mitigate systemic risk.

The Functional Approach

The Functional Approach to financial supervision involves regulating activities across functional, as opposed to legal entity, lines. The clear benefit of a Functional Approach to supervision is that, at least in theory, a single, technically expert regulator will apply consistent rules to the same activity regardless of the entity in which it is conducted. Regulatory arbitrage, which can occur when multiple regulators interpret and enforce the same, or perhaps even inconsistent, rules in different ways, is avoided under this approach. As an acknowledged expert agency, the regulator may be better able to attract and retain highly qualified subject matter experts who can interpret and apply applicable rules to the same functions across different legal entities.

One of the major challenges of functional regulation is that it can be extremely difficult to distinguish which activity comes within the jurisdiction of a particular regulator.

As regulators expand the scope of permissible activities of the entities under their watch, there is a general reluctance to cede to another agency authority for overseeing those new activities. A related and quite significant concern with the Functional Approach is that product innovation can be inhibited as functional regulators spar over jurisdiction. This problem is often cited in the case of the SEC and the CFTC in the United States. Disputes over whether certain products are securities or futures, whether the SEC or the CFTC has authority to regulate them, and which rules apply have hindered the introduction of certain new products by securities and futures exchanges in the U.S. In some instances, activity has migrated to countries where this regulatory uncertainty does not exist. Thus, one negative consequence of this jurisdictional uncertainly is to drive business offshore.

Another disadvantage of the Functional Approach is that it forces financial institutions to deal with multiple regulators, which is often more costly in terms of time and effort. There is a tendency for multiple regulators to duplicate efforts to some degree. In rare instances, supervisors may take disparate regulatory positions relative to the same activity, putting the regulated institution in an untenable situation. Multiple regulatory agencies must expend much time and effort coordinating and communicating among themselves.

> The clear benefit of a Functional Approach to supervision is that, at least in theory, a single, technically expert regulator will apply consistent rules.

As multiple regulators compete for jurisdiction, not just nationally but also internationally, they may act to gain favor with regulated entities by being more aggressive or permissive in ways that benefit the firms. Some may argue that regulatory competition can lead to more efficient outcomes, as no single monolithic bureaucracy has ultimate decision-making authority. The contrary may be just as likely, however. Regulatory competition may lead to a “race to the bottom,” particularly if an institution has a choice of regulator for a particular activity and the regulator’s budget is funded by assessments of the entities it oversees. At its worst, a regulator highly reliant on assessments may be particularly vulnerable to regulatory capture, which can compromise its vigilance.

There are other challenges to the Functional Approach. A major disadvantage is that no regulator has sufficient information concerning all the activities of any particular entity or entities to monitor for systemic risk. Also, addressing systemic risk may require having a single regulator with authority to mandate actions across the entire financial system. No functional regulator may be in a position to fulfill that role.

The Integrated Approach

The Integrated Approach to financial supervision garnered much favor in the last several years, as regulators and policymakers in many jurisdictions recognized that changes in the business models of financial institutions and proliferation of financial products warranted commensurate reform of oversight methodologies. Several jurisdictions reviewed for this report, including Germany, Japan, Qatar, Singapore, the United Kingdom and, as of January 1, 2009, Switzerland, have adopted this approach.

> The Integrated Approach has the advantage of a streamlined focus on regulation and supervision.

As with other models, there are both positives and negatives about this approach. First, the Integrated Approach has the advantage of a streamlined focus on regulation and supervision without confusion or conflict over jurisdiction lines that are possible under both the Institutional Approach and the Functional Approach. This clarity of focus potentially leads to higher-quality regulatory outcomes. Another significant advantage of the Integrated Approach is that it provides a more comprehensive, panoramic view of the regulated entity's business. The oversight perspective is potentially not only deep but also broad. The supervisor can test for compliance with regulatory requirements and also review business issues, management quality, risk management, and control issues on a prudential basis. It essentially gives the supervisor the ability to look holistically at an entity and to respond to changes in a timely manner. Oversight of financial institutions that are involved in multiple business lines can be vastly simplified and presumably more efficient and cost-effective with a single regulator. It is also undoubtedly the case that many supervised entities prefer an integrated supervisory approach. Certainly, with one regulator, a firm is more likely to experience consistent application of rules and is less apt to be caught in jurisdictional disputes between regulators.

Notwithstanding the merits of the Integrated Approach, there are also potential downsides to this model. Some observers suggest there are concerns related to having a single point of failure. If an integrated regulator fails to spot an issue, there is not another agency to potentially fill the void. Defenders of fragmented regulation maintain that overlapping jurisdiction potentially may increase the likelihood of a supervisor recognizing a problem or issue. With a single monolithic regulator, no such system of checks and balances exists.

In a very large market, there may be concern that an integrated regulator might simply be too large and thus too cumbersome to be managed effectively. A large integrated supervisor that regulates across all business sectors will likely have to divide its workflows into manageable functional or other business units. For example, the Japanese FSA, as an integrated supervisor, regulates the financial institutions under its jurisdiction by function and is so organized internally. Likewise, BaFin, as the integrated regulator in Germany, is generally organized along sectoral lines, with separate departments created to handle entities that cross various lines. Thus, communication among the various functional divisions of a large, unified regulator is as important and may be as challenging as it would be across separate organizations. There is no certainty, for example, that a derivatives expert within a single integrated supervisor is more likely to draw upon the expertise of the insurance experts within the same organization than he or she would if the two disciplines were located in separate entities.

There are concrete examples of the challenges of coordination that are experienced even when the Integrated Approach is adopted. In Germany, notwithstanding that BaFin is an integrated regulator, the Bundesbank continues to play a role in banking supervision. This reflects historical circumstances and is due in large part to the Bundesbank's expertise in banking supervision and its interest in having an in-depth view of banking activity as it relates to its monetary policy role. This has led to some overlaps and duplication in audits, issues that admittedly may be manageable through effective coordination efforts. The Bundesbank and BaFin have addressed this issue by entering into a Memorandum of Understanding regarding their respective roles. A single, integrated regulator, by definition, mitigates coordination and information-sharing problems, but the agency must still work to ensure coordination between the central bank and ministry of finance.

The critical self-assessment by the FSA of the run on Northern Rock in the U.K. highlights the challenges of managing a single, large agency that is responsible for the regulation, supervision, and examination of all sectors of the financial industry, including banks, insurance companies, securities firms, mutual funds, hedge funds, and private equity firms. In its analysis of lessons learned, the FSA points to internal reorganizations that resulted in, among other things, responsibility for Northern Rock being under three different heads of departments in as many years. The FSA also cites the possibility that a very demanding workload may have strained internal resources. It notes the breakdowns in flows of intelligence and information both internally and externally. The FSA recommends internal structural changes and cultural shifts within the organization to address the shortcomings identified through its internal assessment.[16]

A single, integrated regulator has the potential to become a classic monopolistic bureaucracy, with all the related inefficiencies. This model by definition lacks regulatory competition. Some commentators advocate competition among regulators to ensure that they are challenged to outperform their competitors. Of course, others observe that there is no certainty that the opposite will not occur—that there will be a race to the bottom as regulators compete to be in the favor of the firms they oversee.

A single, integrated regulator has the potential to become a classic monopolistic bureaucracy...

The Twin Peaks Approach

The Twin Peaks Approach to financial supervision is designed to garner all the benefits and efficiencies of the Integrated Approach, while at the same time addressing the inherent conflicts between the objectives of safety and soundness regulation and consumer protection and transparency. The Twin Peaks Approach has been referred to as "regulation by objective." One agency's regulatory objective is prudential supervision with the primary goal of safety and soundness. The

[16] FSA Internal Audit Division, *The Supervision of Northern Rock: A Lessons Learned Review*, March 2008 (available at www.fsa.gov.uk/pubs/other/nr_report.pdf).

second agency's goal is to focus primarily on business conduct and consumer protection issues.

The Twin Peaks Approach may help insulate prudential supervisors from an excessively intrusive consumer-oriented approach. When safety and soundness mandates conflict with consumer protection issues, the prudential supervisor may give precedence to safety and soundness mandates, because these are closely intertwined with financial stability. However, even when the two objectives are divided among separate regulators, tensions may remain, especially when prudential and systemic stability concerns are seen to override consumer protection issues in the case of institutional failures. Such decisions concerning which goals take precedence are ultimately subjective, based on the institutional positions of the respective actors and regulatory agencies.

The Twin Peaks Approach may also be the optimal means of ensuring that issues of transparency, market integrity, and consumer protection receive sufficient priority.

The Twin Peaks Approach may also be the optimal means of ensuring that issues of transparency, market integrity, and consumer protection receive sufficient priority. Each of the investor protection and market conduct mandates can receive singular focus. The approach is designed to ensure that sales practice protections apply uniformly across all financial products, regardless of the legal status of the entity selling the product.

This approach to financial supervision is gaining currency as a means of achieving the benefits of the Integrated Approach with the added distinct emphasis on consumer protection issues, particularly for retail customers. Under this approach, each regulator can hire employees with appropriate expertise for their specific functions. Prudential regulators can employ persons with business and economic expertise while business conduct regulators focus on hiring enforcement-oriented staffs. Having the functions in separate entities can minimize the conflicts between the disparate disciplines. This approach has been adopted in three of the jurisdictions studied in the profiles—Australia, the Netherlands, and, in the near future, Spain.

The U.S. Treasury Blueprint advocates the adoption, over the long-term, of a model that is similar to the Twin Peaks Approach, and is based on regulation by objective. The objectives encompass three key goals: market stability, prudential supervision, and business conduct. The institutional structure underpinning these objectives differs from the classic Twin Peaks Approach in a number of ways.

The Treasury Blueprint differs from existing Twin Peaks models in that it advocates having a business conduct regulator that is separate from the transparency and markets regulator. It proposes that the latter two functions remain with the SEC. The jurisdictions that currently have adopted the Twin Peaks Approach link investor protection with market fairness and transparency mandates and have a single regulator in charge of all three mandates. Presumably, since most securities regulators have significant experience with business conduct regulation, this role has tended to be delegated to securities regulators in the jurisdictions that have adopted the Twin Peaks Approach. This conduct-of-business focus is not limited to rulemaking authority. It also encompasses developing arbitration or mediation systems, ombudsmen programs, and other means of investor remediation.

The Role of the Central Bank

The financial turmoil that unfolded in several economic centers in 2008 tested the ability of supervisors to respond effectively to financial crises. It also brought into sharper focus the optimal role of central banks, both in benign market conditions and during times of severe financial stress. In addition to the role of central banks in implementing monetary policy, in most developed economies they perform one or more additional essential functions, including acting as a prudential supervisor, ensuring financial stability, and acting as a lender of last resort.

A threshold question arises whether the central bank should be a supervisor of financial services or whether that role is best performed by another agency. There are strong sentiments on both sides of this issue. Those who support central bank involvement in financial supervision maintain that central banks bring significant expertise to the function that might be compromised if the role were assigned to another supervisor. Indeed, some believe that central banks have a supervisory competitive edge due to their superior knowledge of market conditions and the depth of their staffs' expertise. Central banks tend to understand well the business of financial institutions by virtue of their market functions. They may be in a uniquely advantageous position to shape the regulatory environment in ways that are particularly beneficial in times of financial crisis. Through their role as supervisors, central banks can respond directly to issues they identify, and can require entities they supervise to take certain steps aimed at mitigating systemic risk.

As banking supervisors, central banks have a window into financial activity that is essential to the performance of their other functions, such as setting interest rates and performing a lender-of-last-resort role. They are uniquely suited to function as liquidity providers in a crisis given their access to funding, their knowledge of the financial institutions they oversee, and their relative independence from political pressures.

Central banks have a supervisory competitive edge due to their superior knowledge of market conditions and the depth of their staffs' expertise.

In the United States, for example, the Federal Reserve, in 2008, provided access to the discount window to systemically important institutions such as primary dealers and investment banks that, as nondepository institutions, were not subject to central bank oversight. It became clear, however, that the Federal Reserve needs substantially more in-depth information concerning these financial institutions before it can prudently extend credit. This information includes all of the financial, business, and operational information that is customarily available to a prudential supervisor. Thus, the Federal Reserve, in July 2008, entered into a precedent-setting Memorandum of Understanding (MOU) with the SEC[17] providing that the Federal Reserve and the SEC will jointly formulate supervisory guidelines or rules concerning capital, liquidity, and funding positions and resources and associated risk management systems and controls for SEC-regulated entities that have access to the discount window. The MOU further provides that the Federal Reserve and the SEC will collaborate in communicating expectations with these entities. It also provides that

[17] *Memorandum of Understanding between the U.S. Securities and Exchange Commission and the Board of Governors of the Federal Reserve System Regarding Coordination and Information Sharing in Areas of Common Regulatory and Supervisory Interest*, July 7, 2008 (available at www.sec.gov/news/press/2008/2008-134_mou.pdf).

the joint oversight of these entities will continue even if the lending facilities are terminated. The latter provision illustrates the strong desire of the Federal Reserve to access key information on these systemically important non-bank players in order to better satisfy its monetary policy, financial stability, and lender-of-last-resort mandates.

A number of the jurisdictions reviewed embrace the view that by virtue of its bank supervisory function, the central bank is better equipped to perform its other roles related to monetary policy, financial stability, and payment systems. Germany's central bank, for example, has retained a number of supervisory functions, even though the Integrated Approach has been adopted in Germany and a number of functions have been shifted to the unified regulator, BaFin. The German central bank appears to want to continue to have a role in supervising banks, in large part to stay abreast of developments in the marketplace and to bolster its lender-of-last-resort capability.

In Brazil, France, Hong Kong, Italy, Spain, the Netherlands, Singapore, and the United States, the central bank is also a safety and soundness supervisor of the banking sector. Thus, the central bank performs this additional role in several countries without regard to the approach to financial supervision they employ. Central bankers who are also safety and soundness supervisors believe that a bank's supervisory activities contribute to its financial stability role. They maintain that the link between liquidity management and central bank operations is key to effectively addressing financial crises and, moreover, that when supervision extends to investment banks, such as in France, a central bank's supervisory activities garner insights into nascent market issues, enabling it to respond in a more timely manner.

Those who oppose having the central bank take on a supervisory role for banks raise concerns that the central bank might become too powerful and omnipresent in financial matters. They also raise concerns that the central bank may become overwhelmed by its equally challenging mandates of setting monetary policy and regulating the banking sector. They oppose centralizing so much responsibility and authority in a single entity. When the central bank is involved in both supervision and monetary policy, senior management time may be strained without additional resources or careful resource allocation. Others argue that there are inherent conflicts between the role of the central bank as a prudential supervisor and that of a financial stability or monetary policy authority. Conversely, some would argue that these conflicts are better handled within one agency that can balance the various objectives against one another before taking a decision. Jurisdictions we reviewed in which the central bank's role does not include that of a prudential regulator include Australia, Canada, China, Japan, Mexico, Qatar, Switzerland, and the United Kingdom.

The policy debate over the role of the central bank has been particularly robust in the United Kingdom since the run on Northern Rock. Since 1997, after the problems with the Bank of Credit and Commerce International (BCCI) and Barings, regulation and supervision of banks has rested with its unified regulator, the FSA. At that time the Tripartite Authorities in the United Kingdom entered into an MOU, which was updated in 2006. Under the MOU, the Bank of England's responsibilities include "the maintenance of the stability of the financial system as a whole," while the FSA has responsibility for the authorization and supervision of individual banks. In a crisis, the MOU provides that the FSA is responsible for "the conduct of operations in response to problem cases affecting firms, markets and clearing and settlements systems within its responsibilities," which may include changing capital or other regulatory requirements and facilitating a market solution involving, for example, an introduction of new capital. The lender-of-last-resort function in the U.K. resides in the Bank of England.

In light of criticism that the Tripartite Arrangements were found wanting and that the Tripartite Authorities did not act quickly enough to avert a run on Northern Rock, some have argued that the supervisory role for banks should be returned to the Bank of England. These critics maintain that it is very difficult for a central bank that is the lender of last resort to act quickly when the government agency with knowledge of the particular failing bank is not the same agency that is responsible for extending the credit. By definition, lenders of last resort need timely and complete information on which to act promptly. The Tripartite Authorities have defended the division of responsibility for the regulation of financial institutions and the lender-of-last-resort responsibility between the FSA and the Bank of England, with Her Majesty's Treasury chairing the Tripartite body charged with making such decisions. This division of responsibilities is thought by some senior officials to be prudent because it is felt that one institution—a central bank—may not be able to manage both monetary policy and the entire range of financial supervision. In the U.K., the Chancellor of the Exchequer has strongly supported these separate roles for the FSA and the Bank of England.

The U.S. Treasury Blueprint contemplates a similar division of duties between a prudential supervisor and the central bank. The Treasury Blueprint promotes a new supervisory architecture for the U.S. that is an "objectives-based" regulatory approach designed to focus on three goals of regulation—market stability, safety and soundness through prudential oversight, and appropriate business conduct. Under this regime, the Federal Reserve would be in charge of market stability regulation. The Treasury Department believes the Federal Reserve should be assigned this role due to its traditional central bank role in promoting overall macroeconomic stability. Elements of this function would be conducted through the implementation of monetary policy and the provision of liquidity in the system. The Federal Reserve would also be given additional powers, such as the power to gather information, make disclosures, and collaborate with other regulators on rule writing and corrective action. It also would have the authority to require corrective action, but only when overall financial market activity was threatened. This role would replace, and be in lieu of, the Federal Reserve's current role as a supervisor of banks and bank-holding companies. Under the proposal, prudential supervision of banks and investment banks that is currently performed by five banking agencies and the SEC and the CFTC would be consolidated into a single, independent regulator.

Since the publication of the Treasury Blueprint, and as the credit crisis has deepened in the United States, the role of the Federal Reserve as a supervisor, lender of last resort, and market stability supervisor increased perceptibly. This enhanced role for the Federal Reserve contrasts with the tenor of the recommendations in the Blueprint. Indeed, the Federal Reserve is taking a much more active role in supervision of primary dealers and systemically important investment banks. It would appear that, notwithstanding previously expressed concerns over both the Federal Reserves' ability to handle such large mandates and its ability to balance the various and potential conflicting functions, in times of financial stress there is a tendency to turn to the central bank more than any other arm of the government for assistance.

The Role of Deposit Insurance

Deposit insurance schemes have come under greater scrutiny after the run on Northern Rock in the U.K. Deposit insurance can play a critical role in avoiding bank panics and thus may contribute to financial stability. A consensus seems to have emerged in the U.K. that the existing deposit insurance regime was inadequate to inspire depositor confidence and prevent a run on the bank. The House of Commons Treasury Committee, in its Fifth Report of Session 2007–2008, entitled "The Run on the Rock,"[18] reached a series of conclusions and recommendations that have informed recent U.K. legislative proposals. These "lessons learned" are highly instructive in fashioning a successful deposit insurance scheme.

Any regime must be structured to ensure that depositors' funds can be accessed promptly.

Any regime must be structured to ensure that depositors' funds can be accessed promptly. Among other things, insured deposits should be segregated to reassure depositors that their funds are both safe and accessible. In the absence of confidence that they will have ready access to their funds, depositors will have a strong incentive to join a bank run and withdraw their deposits.

Some observers believe that the U.K. deposit insurance scheme's inclusion of a complicated co-insurance element may have contributed to the run on Northern Rock. For example, depositors' funds were insured 100 percent only on the first £2,000 (British pound sterling), and 90 percent on the next £33,000. This complexity detracted from depositor confidence and indeed incentivized depositors to withdraw all of their finds in order to avoid any potential for loss sharing on their part. The most successful deposit protection schemes are those that are as simple and transparent as possible. This means providing clear explanations of how depositors can maximize their protection. To provide the optimal financial stability benefits, the details of the scheme must be well advertised and readily accessible.

Depositors also expect that a deposit insurance scheme will be adequately funded in order to meet any potential obligations. Failure to provide this assurance likewise fails to meet the objective of financial stability. This entails the ex ante capitalization of a deposit protection fund, most likely with monies provided through assessments from the banks. The size of the fund depends on the amount of insured deposits in the system and the likelihood that any particular institution will fail. It may be particularly challenging to adequately fund a deposit insurance scheme in a small jurisdiction where there is a high concentration of deposits in only a few dominant institutions. In the absence of collecting very high

[18] Issued January 24, 2008 (available at www.publications.parliament.uk/pa/cm200708/cmselect/cmtreasy/56/5602.htm).

deposit insurance assessments from those institutions, the only means to adequately fund such a regime may be through direct government funding. Failure to do so may increase the likelihood that depositors will not be fully protected in accordance with their expectations.

An examination of the jurisdictions we reviewed reveals the widespread adoption of deposit protection schemes in most financial centers. The exceptions include Australia and China, although both are now in the process of establishing deposit protection schemes. We can conclude that all jurisdictions studied recognize the importance of such schemes and their role in shoring up depositors' confidence in the financial system generally, and in the safety of the deposits in covered bank accounts specifically.

Domestic Coordination Issues among Supervisors

Virtually all supervisors cite the importance of intragovernmental coordination and information sharing for successful oversight of the financial system and the mitigation of systemic risk. Maintaining adequate levels of cooperation and information sharing across governmental agencies appears to be both equally important and challenging regardless of the supervisory approach adopted in the jurisdiction.

In the United States, one of the primary means of coordination among the Treasury, the Federal Reserve, the SEC, and the CFTC is the President's Working Group on Financial Markets (PWG), which was formed in the aftermath of the 1987 stock market crash. The PWG has been the interagency coordination mechanism for financial market regulation and policy issues since 1988. Its mandate was expanded in 2008 by the U.S. President pursuant to recommendations made in the Treasury Blueprint. Its focus now includes the entire financial system rather than solely capital markets. It also will focus on four discrete areas: mitigating system risk to the financial system, enhancing financial market integrity, promoting consumer and investor protection, and supporting capital market efficiency and effectiveness. Also, the Treasury Blueprint recommended that membership of the PWG should be expanded to include the Comptroller of the Currency and the heads of the Federal Deposit Insurance Corporation and the Office of Thrift Supervision.

In addition to the PWG, there are various bilateral MOUs between the federal agencies that relate to information sharing. These MOUs have taken on increased importance in the aftermath of the Bear Stearns wind down, where the inability of the firm, which appeared to be adequately capitalized, to obtain financing in the overnight repo (repurchase agreements) markets seems to have caught the regulators by surprise. This event has exposed the weaknesses of a regulatory system in which functional regulators may be well informed of the financial condition of the regulated entity, but not have timely information on the state of the markets in which they are operating. This entails bringing together the disciplines of multiple supervisors, in this case the SEC and the Federal Reserve, the latter having a better perspective on the funding markets given its own open market operations. The MOU between the Federal Reserve and the SEC signed in July 2008 was in direct response to this perceived need for greater coordination and information sharing with respect to certain systemically important firms.

A majority of the jurisdictions reviewed in this report employ a PWG-type approach, which melds an MOU (or series of MOUs) between agencies with some form of financial stability committee tasked with ensuring information exchange and coordination between the leadership of the central bank and other supervisory agencies. In most cases, this coordination committee is a permanent feature of the structure; it works in both normal times and in times of crisis. In other cases, such as in Japan, the committee may only be triggered when a banking failure is imminent.

A majority of the jurisdictions reviewed in this report employ a PWG-type approach…

Where this structure is employed, those interviewed indicate a financial stability committee helps deliver better agency coordination, allowing for a frank exchange of views among a small leadership group, on a regular basis. In addition, such a coordinating committee structure often results in closer coordination between and among agencies at a deputy or lower level, in part because of necessary preparatory work for the regular principals' meetings and the ongoing linkages among agencies that this creates.

In Hong Kong, for example, the four main regulatory bodies—the Hong Kong Monetary Authority (HKMA), the Securities and Futures Commission (SFC), the Office of Commissioner of Insurance (OCI), and the Mandatory Provident Fund Schemes Authority (MFSA)—have all signed a series of bilateral MOUs to further enhance cooperation on regulation, supervision, information exchange, and mutual assistance. There are also two high-level coordinating committees. One is the Financial Stability Committee, which meets once a month. It monitors the banking, securities, and derivatives markets for financial stability. The Committee is chaired by the Financial Secretary and includes the HKMA, the SFC, and OCI. The other committee is the Council of Financial Regulators. This forum for discussion for high-level officials is chaired by the Finance Minister and includes, among others, the SFC, OCI, and the MPFA.

Similarly, Spain employs a series of bilateral MOUs and a Financial Stability Committee (CESFI) to coordinate the efforts of the Ministry of Economy and Finance, the Bank of Spain, the National Securities and Exchange Commission (CNMV), and the General Directorate of the Insurance and Pension Fund (DGSFP). This Committee was created in 2006 in response to recommendations from the European Union (EU) that all national financial regulatory authorities should seek to establish similar coordination mechanisms designed to anticipate and coordinate in times of financial stress and/or crisis. The Committee meets once a month. It focuses on contingency planning for financial stress and for unforeseen events such as terrorist attacks.

Spain also employs a technique for coordination that is used in several other jurisdictions as well; that is, cross-board memberships. The Ministry, the Bank of Spain, and the CNMV, for example, have representatives on their boards from the other agencies.

France makes liberal use of interlocking boards to enhance the opportunities for coordination among financial supervisors. For example, each of the boards of the Insurance and Mutual Societies Supervisory Authority (ACAM) and the Banking Commission has representatives from the other. France also has a board—the Board of Financial Sector Authorities (CACESF)—that brings together the Governor of the

Bank of France, the Chair of ACAM, the Chair of the Financial Markets Authority (AMF), and the Minister of the Economy to discuss issues of common concern.

Mexico also employs similar coordination techniques. It has interlocking boards among the financial supervisors, it makes use of bilateral MOUs, and it established a Financial Stability Committee modeled after the PWG in the United States.

Of course, having a PWG-type structure in place does not guarantee coordination among principals, who may not concur on policy matters, but those interviewed felt that having a structure of MOUs and a financial stability committee in place helps engender closer ties and better coordination that can pay dividends in times when speed is of the essence and decisions must be taken with dispatch.

In "The Run on the Rock," the House of Commons Treasury Committee examined the role of the Tripartite Authorities at the time of the Northern Rock crisis. The report notes the Tripartite Authorities could have perhaps more effectively coordinated in order to act to thwart a run on the bank. While the U.K. has a single unified supervisor that was widely viewed as quite effective during normal times, in times of crisis, when coordination with other areas of the government was crucial, these arrangements were viewed as inadequate. Accordingly, it has been proposed by the government that one of the two existing Deputy Governor positions at the Bank of England also be designated as Head of Financial Stability, have a specific focus on systemic issues, and be responsible for handling failing banks and overseeing the Deposit Protection Fund. The proposed legislation would strengthen, without radically changing, the existing arrangements among the Tripartite Authorities. Among other things, the legislation would explicitly recognize the Bank of England as the financial stability regulator, introduce a resolution regime to deal with failing banks, change the deposit insurance regime in a manner that would make it easier to understand, and provide for faster payments to depositors and measures to improve coordination among the Tripartite Authorities.

These arrangements, in normal circumstances, would provide for the FSA to be the supervisor of financial institutions, with the Bank of England having access to information obtained by the FSA. In troubled times, when it appears that a financial institution is having difficulties, the entity will become subject to heightened supervision, and the Bank of England, as a potential lender of last resort, may want more direct and fulsome data from the entity. There would also be heightened information sharing among Tripartite Authorities during this period. Thus, the legislative proposal in the U.K. seeks to create an arrangement for benign periods that can more expeditiously shift into effective crisis management arrangements as necessary.

> Having a structure of MOUs and a financial stability committee in place helps engender closer ties and better coordination.

It is noteworthy that under the Integrated Approach, which could be viewed as the most streamlined approach to financial supervision, supervisors still must work tirelessly to coordinate with other financial oversight bodies—primarily with their ministries of finance and central banks—in order to effectively monitor for financial stability and systemic risk. The U.K. experience points to the challenges of ensuring that arrangements that are viewed as highly effective in benign periods will also withstand the shocks of a financial crisis.

In summary, those interviewed agree that close and effective coordination and cooperation among the ministry of finance, the central bank, and supervisors is essential, whatever form of financial regulatory structure a country or market adopts. Efforts to enhance coordination at the highest levels of the agencies can be adversely affected if principals clash personally or disagree over respective roles and objectives. Ultimately, a collaborative tone must be established at the top by the individuals in charge. MOUs may provide a necessary underpinning of these linkages in that they can set the ground rules and establish responsibilities, but they are not in and of themselves sufficient to ensure smooth coordination. In many cases, the supervisory authorities have felt it necessary to supplement these agreements with a financial stability committee of principal regulators. Linkages at the top of the central bank and supervisory agencies can be further cemented by cross-board memberships. However, what appears to work in "peacetime" cannot be assumed to work as smoothly in a time of crisis. Many of the frameworks for domestic coordination described in the profiles in Part II of this Report have yet to be tested by the failure of a systemically important financial institution, and few of those interviewed felt entirely confident that the structures in place were adequate to the task of handling a major systemically important bank failure.

> ...close and effective coordination and cooperation among the ministry of finance, the central bank, and supervisors is essential...

Cross-Border Coordination Issues

There are several international fora for cooperation among financial supervisors. With a few exceptions, these groups are organized along the traditional institutional lines of banking, securities, and insurance. As the business models of financial institutions have converged, the need for greater coordination and interaction among these international fora has become more acute. This need for coordination is to a degree addressed by a geographic concentration of a number of these bodies in Geneva (for example, the Basel Committee, the Financial Stability Forum, and the International Association of Insurance Supervisors).

Perhaps the best known of the international committees is the Basel Committee on Banking Supervision, which provides a forum for international cooperation on banking supervisory matters. The Committee members come from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom, and the United States. The Committee's mission is to enhance understanding of key supervisory issues and improve the quality of banking supervision worldwide. The Committee is known for its development of guidelines and supervisory standards that have been widely adopted worldwide, including its Capital Adequacy Standards and its Core Principles for Effective Banking Supervision.

The International Organization of Securities Commissions (IOSCO) brings together securities regulators from around the world to promote high standards of securities regulation in order to promote fair and efficient markets. It functions as a forum for information exchange on domestic experiences in order to promote the development of better markets worldwide. It is also a standard-setting body and promotes enforcement cooperation through its multilateral MOUs.

The International Association of Insurance Supervisors (IAIS) was established in 1994 to bring together insurance regulators from almost 200 jurisdictions, representing about 97 percent of the world's insurance premiums. It seeks to contribute to improved supervision of the insurance industry in order to maintain efficient, fair, safe, and stable insurance markets, promotes the development of well-regulated insurance markets, and contributes to global financial stability.

Two more recently formed international fora seek to foster cooperation and coordination among supervisors across the financial services sectors. The Joint Forum was formed in 1996 under the aegis of the Basel Committee on Banking Supervision (BCBS), the IOSCO, and the International Association of Insurance Supervisors (IAIS). It addresses issues common to the banking, insurance, and securities sectors, including the regulation of financial conglomerates. The membership comprises an equal number of senior bank, insurance, and securities supervisors representing each financial sector. A representative of the European Union is an observer.

The Financial Stability Forum (FSF) is the newest entrant in the field of international fora designed to bring supervisors together from various financial services disciplines. It was convened in April 1999 at the initiative of the G-7 Finance Ministers and Central Bank Governors to "promote international financial stability, improve the functioning of the financial markets and reduce the tendency for financial shocks to propagate from country to country, thus destabilizing the world economy." The FSF's mandate is "(1) to assess vulnerabilities affecting the international financial system, (2) to identify and oversee action needed to address these, and (3) to improve coordination and information exchange among the various authorities responsible for financial stability."[19]

The FSF brings together senior representatives of national authorities (for example, representatives of the central bank, securities regulators, and treasury officials), international financial institutions (such as the IMF, the World Bank, the Bank for International Settlements [BIS], and the Organization of Economic Cooperation and Development [OECD]), international regulatory and supervisory groups (such as IOSCO, the Basel Committee on Banking Supervision, the IASB, and the IAIS), committees of central bank experts (such as the Committee on Payment and Settlement Systems and the Committee on the Global Financial System), and the European Central Bank. Thus, the FSF is a coordinating body that spans all sectors of financial services, but its primary focus is on financial stability and systemic risk.

In addition to participation in these international groupings, a number of jurisdictions engage in information sharing and cooperation bilaterally through MOUs. There have also been some very promising efforts of late for cooperative efforts relating to areas of common concern that may impact financial stability. One particularly noteworthy effort was the joint work of the Banking Commission of France; the Federal Financial Supervisory Authority of Germany; the Federal Banking Commission of Switzerland; the FSA in the United Kingdom; and the Federal Reserve Board, the Federal Reserve Bank of New York, the Office of the Comptroller of the Currency, and the SEC in the United States that resulted in a report entitled, "Observations on Risk Management Practices During the Recent Market

[19] Mandate of the Financial Stability Forum, www.fsforum.org/about/mandate.htm.

Turbulence." The effort brought together senior supervisors of major global financial services organizations to assess which risk management practices worked well and which did not during the recent period of market turmoil. It summarizes the results of supervisory reviews and a roundtable discussion that the supervisory agencies held with industry representatives. The report is significant not only for its findings, but also for its success in achieving collaboration among supervisors on an ad hoc basis to examine a significant issue of global importance. It has encouraged supervisors to share findings and work cooperatively to address weaknesses in the financial system. Also, observations noted in the report have helped to define an agenda for strengthening supervisory oversight in certain relevant areas.

...virtually all of the jurisdictions we reviewed support the efforts of these international groups in furthering cooperation and information sharing.

Representatives of virtually all of the jurisdictions we reviewed support the efforts of these international groups in furthering cooperation and information sharing. There is significant debate, however, concerning whether these efforts are enough or whether greater coordination efforts need to be in place, particularly in crisis situations.

Some jurisdictions favor more formal mechanisms for cooperation and information sharing. Still others indicate the need for more real-time access to information and believe that formal mechanisms will promote more timely information exchange.

A number of those interviewed were supportive of more widespread use of a series of "colleges of supervisors" on the international level focused on large systemically important financial institutions. Such colleges may indeed be good fora for more formalized information exchanges and cooperation between home and host supervisors. However, a number of those interviewed felt that they should not become overly large and must remain flexible as to membership, size, and composition, with these decisions being taken by the home supervisor.

Within the European Union, some supervisors favor establishing a more elaborate system of coordination first at the EU level, and then exporting the concept internationally. Some supervisors cited international cooperation as the first and necessary step toward convergence of supervisory practices and regulations, and believe the new EU MOU will be an important step forward when enacted. This EU MOU is only part of the European Community's structure designed to deal with crisis management. (See Part II of this Report for a more detailed description.) None of the European supervisors reviewed supported the creation of an EU-level supervisor at this stage, preferring instead to work on reinforcing the structures for coordination and cooperation among national agencies and central banks.

In general, the review found support for the use of colleges if they can enhance information exchange and coordination. Many supervisors believe that international groupings such as Basel, the FSF, and the IOSCO need to be supplemented by colleges that facilitate communication between home and host supervisors in normal times so as to prepare the lines of communication for times of systemic crises.

But not all of those interviewed felt that more colleges are necessary. Some supervisors believe that the current levels of coordination and information exchange are adequate. They express concern that a formal, structured college to deal with crises is unnecessary and potentially cumbersome. Critics of colleges do not want excessive and prescriptive over-formalization of the process. They point to recent events as having shown that supervisors know whom to call when a problem arises. If answers are not timely, it is generally due to the fact that supervisors are overwhelmed with the tasks at hand, and not to any reluctance to share information. These regulators expressed the view that bilateral and multilateral coordination is far more successful than a college system. They are generally pleased with the level of cooperation and do not recommend structural changes at this time.

Lessons Learned From Recent Experiences

As the turmoil caused by the credit crisis in the United States spread to other economies, it provided financial supervisors across the globe with unanticipated opportunities to test the effectiveness of their supervisory approaches under stress conditions. Regulatory approaches and methodologies that may have worked well under benign financial conditions may break down during a major market disruption.

The study has found no simple correlation between the regulatory approach adopted in a jurisdiction and its effectiveness during a financial crisis. The U.K. experience in the case of Northern Rock illustrated that even those using an Integrated Approach to financial supervision, with its streamlined unified regulator, may also face challenges in times of a banking failure. While this approach was viewed as highly successful in periods of calm, existing arrangements were found to need strengthening after the run on the bank.

On the other hand, notwithstanding its somewhat dated and complex regulatory structure, U.S. regulators have been viewed by some as responding in a timely and aggressive manner to recent conditions. The sale of Bear Stearns to JPMorgan Chase that U.S. financial regulators facilitated over a weekend, followed promptly by the unprecedented access to the Federal Reserve discount window that was granted to government dealers and systemically important investment banks, evidenced the relative success of existing arrangements.

> Regulatory approaches and methodologies that may have worked well under benign financial conditions may break down during a major market disruption.

Clearly, the U.S. regulatory approach did not alone contribute to this success. What seems to have worked well were the mechanisms that financial supervisors had in place that fostered efficient coordination in a crisis. In particular, the ongoing and fluid communication among regulators, fostered by coordinating devices such as the President's Working Group on Financial Markets, provided the backdrop for U.S. financial supervisors to respond quickly and decisively. That said, some observers believe that the U.S. regulatory structure did not effectively identify the emergence or mitigate the results of the credit turmoil, highlighting the need for a significant restructuring of the financial supervisory architecture.

Similarly, one can point to the French regulatory response to the unprecedented losses due to unauthorized trading at Société Générale as evidence of the success of the French regulatory structure, and in particular the ability of all concerned to coordinate effectively.

This is not meant to suggest, however, that regulatory approach does not matter.

The Integrated Model and the Twin Peaks Model may more rationally reflect the changes that have taken place in the financial services business over the past several years, and thus are widely viewed as more efficient and cost-effective by both regulators and regulated entities.

Those who operate under the legacy models—the Institutional Approach and the Functional Approach—expressed confidence in their ability to meet the goals of regulation, but there are clearly challenges to doing so in efficient ways, given the redundancies in jurisdiction. However, making changes to these legacy models should not be undertaken lightly. The process of reform can create costs and burdens. Also, as measured by ability to respond to crises, no one model seems to be clearly superior to the others. Ultimately, to be successful, any regulatory model must also encompass coordination and information sharing among all relevant supervisors—finance ministries, central banks, and financial regulators. These mechanisms must be in place and actively functioning. MOUs and other contractual coordination arrangements may not prove to be as effective in a crisis as ongoing, dynamic arrangements.

The Integrated Model and the Twin Peaks Model may more rationally reflect the changes that have taken place in the financial services business...

Twelve Principal Concluding Observations

Having compiled this report, the Working Group offers the following observations, which have emerged out of the discussions with scores of central bank governors, supervisors, and finance ministries.

1. All policymakers and regulators interviewed underscore the critical importance of regulatory frameworks accommodating and keeping pace with dramatic changes and innovation in financial markets.

2. Many jurisdictions studied have modified or restructured financial regulatory systems within the last 15 years, and a majority are in the process of further restructuring or are actively debating the need for significant changes to modernize their systems.

3. All those interviewed stress the need to have effective coordination among the regulatory agencies, the central banks, and finance ministries. It is critical to maintain good contacts and interaction at all levels in the agencies, including at the principal level and the operational levels.

4. Coordination and communication create challenges, even in jurisdictions that have an integrated regulator, although, other things equal, the challenges are often greater the larger the number of regulatory agencies. Whatever the structure, there is a need for a consolidated view of each supervised institution.

5. Well-functioning groups or coordinating bodies that comprise the heads or senior officials of the regulatory agencies, the central bank, and the finance ministry are particularly important during times of crisis, but can also prove very useful in normal times.

6. We see a trend toward the adoption of integrated regulators and also toward regulation by objective (Twin Peaks), although no one model has proven unambiguously superior

in achieving all the objectives of regulation.

7. Most supervisors stress the importance of an effective, transparent, and efficient deposit protection scheme as a part of today's financial regulatory architecture.

8. Regardless of structure or model, all supervisors stress the importance of communication and coordination with the central bank and the bank's involvement in crisis management.

9. Irrespective of structural approach, central banks everywhere express the critical importance of their having information about, and a direct relationship with, large systemically important financial institutions.

10. A majority of supervisors recognize the value of supervisory colleges for systemically important global financial institutions, but most also believe that flexibility in the procedures and operations of these colleges is critical to their success going forward.

11. Central banks and supervisors remain concerned that current structures for international coordination have yet to be tested by the failure of a systemically important international financial institution.

12. Strong leadership and high-quality people can, to some degree, offset impediments/deficiencies that stem from suboptimal regulatory structures, but at some point regulatory regimes need to be updated and modernized to accommodate financial evolution, market realities, and global integration.

A Final Comment

Issues of structure and design of financial supervisory systems are important, and policymakers should carefully consider reforms aimed at updating their structures to better reflect market realities. That said, recent events have demonstrated that underlying substantive rules are also key to exercising effective regulation. Thus, while a focus on regulatory structure alone clearly will not lead to optimal outcomes, it can undoubtedly contribute to greater regulatory success.

There are many questions related to financial supervision that remain unanswered by this review, however comprehensive it may be. As such, they will have to be addressed by subsequent work, by the G30 or another body. For instance, should unregulated entities (for example, hedge funds and private equity funds) ultimately be integrated into the regulatory structure? Given their monetary policy, financial stability, and lender-of-last-resort responsibilities, what is the optimal role of central banks in the future regulatory landscape? How effectively will regulators deal with the failure of a large financial institution that has systemically important operations in several jurisdictions? What does it mean to "rescue" a failing institution? Do supervisors have the right mechanisms in place to permit the orderly liquidation of major financial institutions? Some of these key questions going to the heart of the current debate over the reform of national supervisory responsibilities will be addressed in a forthcoming G30 study of the future of financial reform. 30

PART II: PROFILES

THE INSTITUTIONAL APPROACH

The institutional approach is one in which a firm's legal status (for example, a bank, broker-dealer, or insurance company) determines which regulator is tasked with overseeing its activity from both a safety and soundness and a business conduct perspective.

China · Hong Kong · Mexico

CHINA

Market Description

China's banking sector is dominated by five state-owned commercial banks: the Agricultural Bank of China, the Bank of China, the Bank of Communications, the China Construction Bank Corporation, and the Industrial and Commercial Bank of China. In 2007, these banks held over 50 percent of total assets of all Chinese banking institutions. There are approximately 8,800 other banking institutions in China, including 29 foreign banks. Total assets held in banking are approximately 52.5 trillion Renminbi (RMB). The securities market in China is relatively new and continues to develop. At the end of 2007, there were approximately 106 securities firms and 59 fund management firms.[1] There are approximately 3,000 insurance institutions with total assets of 2.9 trillion RMB.

Background

Today's financial supervisory and regulatory framework in China is quite new; all major reforms have taken place in the last 25 years. The current institutional approach to supervision in China has begun to exhibit elements of the functional approach toward financial supervision. The system is the result of supervisory and structural reforms that have taken place over a relatively short time. The current organizational setup replaced a previous structure where the People's Bank of China (PBC) was the sole financial supervisor. In 1983, the State Council[2] authorized the PBC to act exclusively as a central bank and as the country's financial supervisor.[3]

Currently, the PBC's supervisory role is limited to formulating and implementing monetary policy, maintaining financial stability, and overseeing anti-money laundering. However, the PBC maintains considerable influence on supervisory policy matters through its Governor's membership on the State Council.

In 1992, to promote development and regulation of the stock market and enhance the socialist market economy, the Securities Commission of the State Council and the China Securities Regulatory Commission (CSRC) were established to supervise the stock market jointly with the PBC. These two institutions merged in April 1998 and took the name of the latter, the CSRC, creating an agency to supervise and regulate the securities sector.

In 1998, to ensure more effective supervision and sound development of the insurance industry, the State Council established the China Insurance Regulatory Commission (CIRC) as an agency to supervise and regulate the insurance sector.

In April 2003, the China Banking Regulatory Commission (CBRC) was established to supervise and regulate the banking sector. Its responsibilities include the supervision of banks, financial asset management companies, trust and investment companies, and other depository financial institutions.

Statutory Framework

The *Law of the People's Republic of China on Banking Regulation and Supervision*, passed by the National People's Congress (NPC) in 2003, authorizes the CBRC to oversee all banks and all non-banking financial institutions. This law, together with the *Law of the People's Republic of China on Commercial*

[1] www.oecd.org/dataoecd/5/32/18469881.pdf.

[2] The State Council is the chief administrative authority of China.

[3] Before 1983, the PBC served as both a central bank and a commercial bank.

Banks, is the legal foundation for China's banking industry, combining financial administrative regulations and prudential supervisory rules. With the development of banking supervisory measures, in which off-site surveillance and on-site examination complement and coordinate with each other, risk assessment and warning mechanisms for the banking industry have been preliminarily established.

The 2006 amendment to the *Law of the People's Republic of China on Banking Regulation and Supervision* extended rights to the CBRC, transforming regulatory oversight. The *Guidance on Compliance Risk Management of Commercial Banks* and the amended *Regulations of the People's Republic of China on Administration of Foreign-Funded Banks* have further improved the banking risk supervision system.

The CSRC has been strengthened through changes in the *Company Law of the People's Republic of China* and the *Securities Law of the People's Republic of China,* which updated the existing securities regulatory laws. Administrative regulations, such as the *Regulation on the Supervision and Management of Listed Companies* and the *Regulation on Supervision and Management of Securities Companies*, have been passed into law.

The CIRC introduced a series of laws to standardize the insurance industry, such as *Regulations on Qualifications of the Directors and Senior Managers of Insurance Companies*, *Regulations on Administration of Insurance Salespersons*, *Provisional Guidelines for Standardization of Governance Structure of Insurance Companies*, *Regulations on Investment Insurance Actuarial System*, and *Regulations on Flexible Insurance Actuary*.

Nonstatutory Elements

The Securities Association of China (SAC) is the self-regulatory organization for the securities industry. It functions under the guidance and supervision of the CSRC and the Ministry of Civil Affairs of China. The SAC supervises and inspects members' conduct, and executes disciplinary measures against those members violating laws and regulations.

Government agencies work with the Insurance Association of China, to strengthen its professional self-discipline and risk-prevention mechanisms.

Institutional Structure of the Regulators

China's financial supervision system is institutional in nature but is exhibiting functional aspects as the economy and financial markets develop. It includes a central bank (PBC) and three parallel institutional supervisory agencies (CBRC, CIRC, and CSRC), as well as others, as follows.

Ministry of Finance (MOF)

The MOF has financial supervision responsibility. The Minister of Finance, as a member of the State Council, has input on supervisory aims and matters of coordination among the agencies.

People's Bank of China (PBC)

The PBC is the central bank of China. The Governor of the PBC is a member of the State Council. The PBC formulates and implements monetary policy, mitigates financial risks, and safeguards financial stability. The main duties and responsibilities of the PBC include issuing and enforcing orders and regulations, formulating and implementing monetary policy, issuing Renminbi and administering its circulation, and regulating the interbank lending and interbank bond markets. Since the reforms of the supervisory system and the creation of the CBRC, the PBC no longer has a direct financial supervisory role, but it nevertheless retains considerable influence over policymaking. The PBC continues to be the primary supervisory body for anti-money laundering.

The PBC management is composed of a Governor and several Deputy Governors. The Governor, nominated by the Premier of the State Council and approved by the NPC, is appointed by the President of China. The Deputy Governors are appointed by the Premier of the State Council. Funding for the PBC, which is a government agency, comes from the State Budget.

State Administration of Foreign Exchange (SAFE)

SAFE manages China's foreign exchange reserves. It is responsible for drafting regulations and authorizing national and foreign financial institutions in conducting foreign exchange operations. It administers the regulations that China uses to keep its currency convertible on the current account (that is, for trade and other purposes), but closed on the capital account (for most types of investment). These systems shield the domestic economy and its banking system from global capital flows. SAFE is an agency within the PBC and is managed by an administrator and four deputies.

China Banking Regulatory Commission (CBRC)

The CBRC is responsible for the supervision of nationwide financial institutions and operations. The *Banking Supervision Law* applies to the supervision of financial asset management companies, trust investment companies, financial companies, and the financial lease companies established within China, and other financial institutions established within China upon approval of the CBRC. The duties and responsibilities of the CBRC include approving new banking institutions, formulating prudential rules and regulations, and a wide range of powers of examination, including off-site and on-site investigation. The commission is also responsible for detecting risk in the banking sector and establishing an "early-warning system."

The CBRC is led by a board consisting of a Chairman, the Discipline Commissioner, and the General Secretary. In 2006, the CBRC had a staff of 18,445, of which 6,680 were engaged in banking supervisory activities.[4] Funding for the CBRC comes from the State Budget.

China Securities Regulatory Commission (CSRC)

The CSRC is responsible for conducting supervision and regulation of the securities and futures markets in China. Major functions of the CSRC include supervision of securities and futures firms, stock and futures exchange markets, publicly listed companies, fund management companies, the securities and futures investment consulting firms, and other intermediaries involved in the securities and futures business. The CSRC seeks to protect investors' rights and interests and to mitigate market risks.

The CSRC has a Chairman, four Vice-Chairmen, a Secretary General, and two Deputy Secretary Generals. Funding for the CSRC comes from the State Budget.

[4] CBRC 2006 Annual Report, page 104.

China Securities Investor Protection Fund

In 2005, the CSRC, MOF, and PBC jointly established the China Securities Investor Protection Fund Co., Ltd, which is responsible for the collection of fees, daily management, and use of the fund. In 2007, the CSRC and the MOF jointly issued the *Regulation on Futures Investor Protection Fund.* The CSRC is responsible for the use and daily management of the fund.

China Insurance Regulatory Commission (CIRC)

Similar to the CBRC's role in the banking industry, the CIRC oversees China's insurance market. The State Council authorizes the CIRC to supervise and regulate the Chinese insurance market. Major responsibilities of the CIRC include formulating insurance industry policies, strategies, and plans; drafting laws and regulations regarding insurance supervision and regulation; examining and approving the establishment of insurance companies; supervising the insurance business operations; and conducting investigations on irregularities and imposing penalties. The insurance supervision system has gradually been established through the CIRC. In 2005, the China Insurance Protection Fund was established and is under the supervision and management of the Insurance Protection Fund Council.

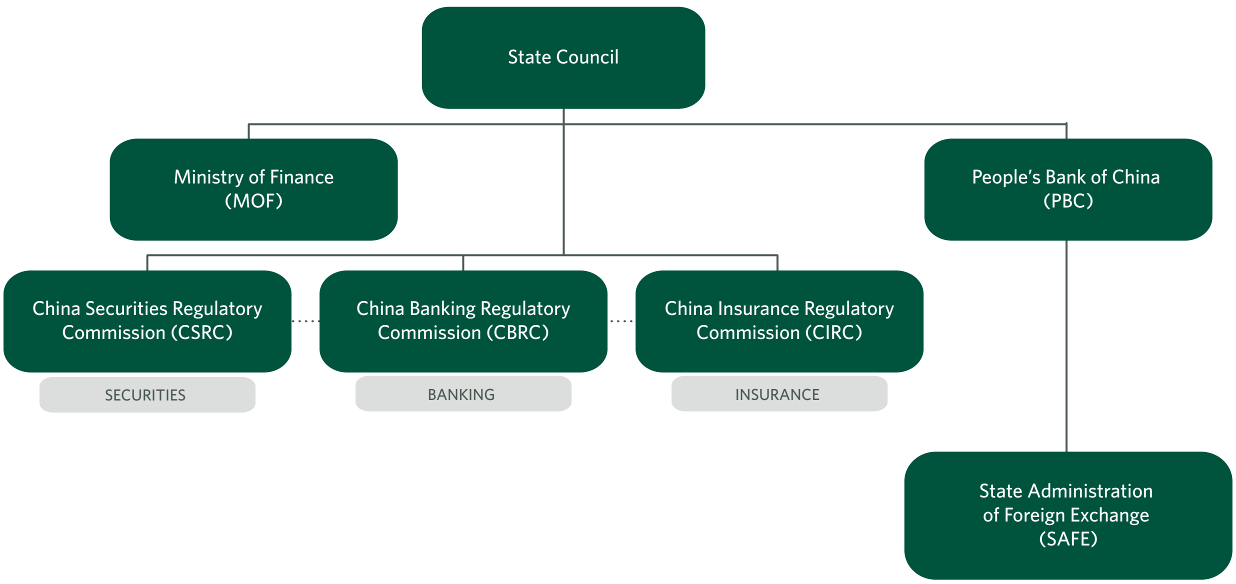
The CIRC is governed by a Chairman, four Vice-Chairmen, a Secretary General, and two Deputy Secretaries General. Funding for the CIRC comes from the State Budget.

Figure 1 provides a graphic depiction of the relationship among the above-mentioned institutions.

Enforcement

When administrative violations occur, the CBRC, CIRC, CSRC, and the PBC have the authority to take enforcement actions,

FIGURE 1. The Financial Services System Regulatory Structure, China



Note: Dotted lines indicate a cooperative relationship.

including imposing fines, the takeover of an institution in crisis, and the injection of liquidity. If a bank faces problems, the CBRC takes the lead, gauging whether it is a liquidity or solvency risk. The CBRC uses on-site supervision to assess the health of the institution. If necessary, the CBRC can request that the PBC inject liquidity into the institution.

The CSRC also has various options and sanctions available in case of failing securities firms. It can require capital injections, provide provisional liquidity support, and back the introduction of overseas strategic investors. When necessary, the CSRC has the power to liquidate and close companies. Governance reforms related to these powers were put in place in 2005. The CIRC has similar enforcement powers.

Violations of specific laws, such as money laundering, are prosecuted by state prosecutors, who file lawsuits against the responsible institutions and/or individuals.

Framework for Domestic Coordination

The State Council, the MOF, the PBC, and the National Development and Reform Commission (NDRC)[5] speak with and coordinate on a regular basis with financial supervisory institutions on various significant issues associated with monetary policy, financial reforms, and financial supervision matters. In August 2000, the CIRC, CSRC, and PBC established a joint conference for financial supervision to discuss issues relating to financial supervision and regulation.

To meet the challenges posed by the trend toward integrated business operations in the financial industry, the need for strengthened coordination and cooperation, the avoidance of supervisory gaps and redundancies, and enhanced supervisory efficiency, in June 2004, the CBRC, CIRC, and CSRC signed the Memorandum on Division of Labor and Cooperation in Financial Supervision, establishing a tripartite system to coordinate activities in financial supervision and coordination.

The Memorandum provides for semiannual meetings at the level of principals. There are further quarterly meetings at the senior deputy level. The chairmanship of the tripartite meetings rotates among each institution on an annual basis. The tripartite meetings discuss issues related to financial stability, financial supervision, and regulation. The respective roles of each institution are clearly defined in the Memorandum, in particular the agencies' individual and collective supervisory roles as applied to holding companies.

Further coordination on securities policy matters is aided by the Task Force on Capital Market Reform and Development, composed of senior representatives of the CSRC, MOF, and PBC, and other related agencies. The task force, chaired by the CSRC, advises the State Council on financial markets reform matters.

None of the coordinating mechanisms above have been tested by financial instability and institutional failures. Chinese authorities recognize that strengthening coordination and cooperation among all the financial regulatory authorities and establishing and improving the mechanisms for coordination of financial supervision are a prerequisite for further improving and safeguarding financial stability and security. To that end, the revised *Law*

[5] The NDRC is a macroeconomic management agency under the State Council, which studies and formulates policies for economic and social development, maintains a balance of economic aggregates, and guides the overall economic system restructuring. Although not a financial regulator, the NDRC has significant impact on financial markets through its economic decision-making powers and prerogatives.

of the People's Republic of China on the People's Bank of China specifies in Article 9 that "the State Council shall establish a coordinating mechanism for financial supervision and regulation." Furthermore, in Article 35, it states, "the PBC shall establish a supervisory information sharing system together with the banking regulatory authority and other financial supervisory authorities under the State Council."

International Coordination

China's supervisory agencies have Memoranda of Understanding (MoUs) with other supervisory agencies. For example, the CBRC has MoUs with over 20 agencies internationally. The CSRC also has MoUs with 39 other securities regulators. The CIRC has MoUs with relevant authorities in Germany, the Republic of Korea, Singapore, and the United States, and Cooperative Agreements on Insurance Supervision with Hong Kong and Macau.

Please refer to the chart of international coordination activities and organizational participation on page 234.

Current Issues

China's financial markets continue to evolve at a rapid pace. Supervisors and regulators understand the need to continue to adjust their regulatory approaches and structures. The State Council has stressed the need to improve coordination among the banking, securities, and insurance regulatory authorities and macroeconomic departments of the PBC and MOF, to enhance transparency and efficiency of financial supervision, and to further strengthen information sharing.

The CBRC, CIRC, CSRC, MOF, and PBC are monitoring the development of businesses and product lines that blur the distinctions among banking, securities, and insurance activities and offerings. They are aware of the possible supervisory overlap or lack of regulatory clarity that can occur among agencies when seeking to exert supervisory authority over new business or product lines.

As part of the continuing evolution of China's supervisory structure, the PBC and the CBRC are in the final stages of designing a deposit guarantee scheme for banking institutions. The scheme will likely be implemented during 2008, and it will be funded ex ante through fees paid to the CBRC.

ACRONYMS AND ABBREVIATIONS

CBRC	China Banking Regulatory Commission
CIRC	China Insurance Regulatory Commission
CSRC	China Securities Regulatory Commission
MOF	Ministry of Finance
MoUs	Memoranda of Understanding
NDRC	National Development and Reform Commission
NPC	National People's Congress
PBC	People's Bank of China
RMB	Renminbi
SAC	Securities Association of China
SAFE	State Administration of Foreign Exchange

HONG KONG

Market Description

Hong Kong[1] is a major international financial center, composed of an integrated network of institutions and markets that provide a wide range of products and services to local and international customers and investors. In 2006, financing, insurance, real estate, and business services constituted 25 percent of gross domestic product (financing and insurance, 16 percent; real estate, 4 percent; and business services, 5 percent).[2]

At the end of February 2008, there were 200 authorized institutions: 142 licensed banks, 29 restricted license banks, and 29 deposit-taking companies.[3] Of these, 66 percent were owned by foreign investors. A total of 68 of the largest 100 banks in the world, from 38 countries, have an operation in Hong Kong. In addition, there are 80 local representative offices of overseas banks in Hong Kong.[4]

In 2007, there were more than 1,400[5] licensed corporations in the securities and asset management industry and 178[6] authorized insurers in Hong Kong, 91 of which were incorporated in overseas countries. At the end of February 2008, there were 40 Mandatory Provident Fund (MPF) schemes and 337 Approved Constituent Funds,[7] both of which are the retirement schemes in Hong Kong.

Background

The financial regulatory system in Hong Kong is best described as having an institutional approach with some functional characteristics. The principal regulators in Hong Kong are the Hong Kong Monetary Authority (HKMA), the Securities and Futures Commission (SFC), the Office of the Commissioner of Insurance (OCI), and the Mandatory Provident Fund Schemes Authority (MPFA). These entities are responsible for regulation in their respective industries of banking, securities and futures, insurance, and retirement schemes.

The current supervisory institutions are relatively new, resulting from the reform of previous institutions, as in the case of banking, securities, and pensions, or the recognition of new needs, as in the case of the insurance sector.

In the case of banking supervision, it was decided, in 1992, in preparation for Hong Kong becoming a Special Administrative Region of the People's Republic of China, to give statutory recognition to certain monetary policy objectives, including the maintenance of the general stability of the monetary and financial systems of Hong Kong, with a view to maintaining Hong Kong as an international financial center.

---

1 On July 1, 1997, Hong Kong became a Special Administrative Region of the People's Republic of China (HKSAR). In this profile, HKSAR refers to Hong Kong.

2 Hong Kong Census and Statistics Department, at www.censtatd.gov.hk.

3 Licensed banks are the only institutions permitted to conduct banking business in Hong Kong. Restricted license banks may take time, call or notice deposits from members of the public in amounts of HK$500,000 and above without restriction on maturity. Deposit-taking companies are restricted to taking deposits of HK$100,000 or more with an original term to maturity of at least three months.

4 www.info.gov.hk/hkma/eng/statistics/msb/index.htm.

5 www.sfc.hk/sfc/doc/EN/research/stat/c01.doc.

6 www.oci.gov.hk/download/poi.pdf.

7 www.mpfa.org.hk/english/quicklinks/quicklinks_sta/quicklinks_sta_sh.html.

This was achieved by amending, in 1992, the *Exchange Fund Ordinance*,[8] to enable the Exchange Fund to be used by the Financial Secretary to maintain the stability and integrity of Hong Kong's monetary and financial systems. At that time, banking supervision was conducted by the Office of the Commissioner of Banking. To assist the Financial Secretary in achieving the statutory monetary policy objectives, it was decided to give the Financial Secretary the power to appoint a person to be the Monetary Authority and to merge the Office of the Commissioner of Banking with the Office of the Exchange Fund to create the Hong Kong Monetary Authority (HKMA) (with the Monetary Authority as its chief executive). The HKMA might be described as a de facto central bank in that it has the policy objectives of maintaining currency stability within the framework of the linked exchange rate system, managing the Exchange Fund, promoting the stability and safety of the banking system, and maintaining and developing Hong Kong's financial infrastructure.

Current securities supervision in Hong Kong was a reaction to the stock market crash of 1987, and to earlier shocks during 1973–74. A review of the 1987 crash led directly to the creation of the Securities and Futures Commission (SFC) in 1989. Until the mid-1970s, stock and commodity markets in Hong Kong were largely unregulated. After the stock market crash of 1973–74, the government intervened, and the core legislation governing the securities and futures industry, the *Securities Ordinance* and the *Protection of Investors Ordinance*, were enacted in 1974.

In 1987, further deficiencies in the regulatory structure became apparent with the October stock market crash, which resulted in a four-day closure of both the Hong Kong stock exchange and the stock index futures markets. In the aftermath of the crash, a committee was created to examine Hong Kong's regulatory structure and regime. In its report, the committee concluded that the Office of the Commissioner for Securities and Commodities Trading had insufficient resources to properly regulate the rapidly growing and changing Hong Kong securities and futures market. It recommended replacing the existing structure with a single statutory body outside the civil service, headed and staffed by full-time professional regulators and funded primarily by the market. In 1989, the SFC was created.

In the early 1990s, the Office of the Commissioner of Insurance (OCI) was established within the government to oversee the administration of the *Insurance Companies Ordinance* (ICO), governing the operation of insurance companies and insurance intermediaries in Hong Kong. At present, the insurance sector remains regulated by the government.

The MPF Scheme, the mandatory, privately managed, and fully funded contributions scheme for retirement protection, was launched in 2000. Before that time, retirement schemes established voluntarily by employers for their employees were regulated under the *Occupational Retirement Schemes Ordinance* (ORSO).[9] Employers are now required to enroll employees in MPF schemes.

[8] This ordinance deals with the control, use, and management of the Exchange Fund, a discrete government fund, which includes Hong Kong's foreign reserves.

[9] ORSO schemes covered approximately 30 percent of the workforce, primarily employees working for larger companies. Faced with an aging population, the Hong Kong government decided to implement a Mandatory Provident Fund, which mandated compulsory coverage of all workers.

Statutory Framework

The powers, functions, and responsibilities of the Monetary Authority are enumerated in the *Exchange Fund Ordinance*, the *Banking Ordinance*, the *Deposit Protection Scheme Ordinance*, the *Clearing and Settlement Systems Ordinance*, and other ordinances. The division of functions and responsibilities in monetary and financial affairs between the Financial Secretary and the Monetary Authority is enumerated in an Exchange of Letters dated June 2003. This Exchange of Letters describes the delegations of authority made by the Financial Secretary to the Monetary Authority under these ordinances.[10]

The *Banking Ordinance*, which was enacted in 1986 (and which has since been regularly amended and updated), provides the legal framework for banking supervision in Hong Kong. Hong Kong maintains a three-tier system of deposit-taking institutions—licensed banks, restricted license banks, and deposit-taking companies. They are collectively known as authorized institutions (AIs).[11]

The *Exchange Fund Ordinance*, originally enacted as the *Currency Ordinance* of 1935, established the Exchange Fund under the control of the Financial Secretary. The Monetary Authority, under delegated authority from the Financial Secretary, has responsibility for the use of the fund.

The *Deposit Protection Scheme Ordinance* of 2004 provided for the establishment of a Deposit Protection Scheme (DPS). The HKMA assists the Hong Kong Deposit Protection Board (the Board) in operating the DPS.

The reform of the securities industry, driven by the need to streamline and update previous ordinances, resulted in the enactment of the *Securities and Future Ordinance* in 2003. The ordinance consolidated and modernized 10 existing ordinances into a single law governing the securities and futures markets. Various rules and requirements were amended, including the introduction of a new licensing regime and new provisions on misconduct, standards, and authorization of investment products offered to the public; rules on investment offering and price stabilization; and disclosure of interests.

The *Insurance Companies Ordinance*, enacted in 1983, prescribes the regulatory framework for insurers and insurance intermediaries. Any company wishing to carry on insurance business in or from Hong Kong must obtain authorization from the Insurance Authority (IA).

The *Occupational Retirement Schemes Ordinance* (ORSO), enacted in 1993, is the governing legislation for the regulation of voluntary occupational retirement schemes operating in or from Hong Kong.

In 1995, Hong Kong enacted the *Mandatory Provident Fund Schemes Ordinance*, which provided the framework for the establishment of the privately managed, Mandatory Provident Fund (MPF) system. The ordinance, amended in 1998 and supplemented by subsidiary regulations enacted in 1998 and 1999, enumerated the detailed rules governing the operation of the MPF system, including the coverage, types of schemes, contributions, compensation claims, and exemption of members covered by certain occupational retirement schemes.[12] The MPF system began operation in 2000.

---

10 HKMA Annual Report 2007, www.info.gov.hk/hkma/eng/public/ar07/pdf/04_about_hkma.pdf.

11 www.info.gov.hk/hkma/eng/bank/index.htm.

12 www.mpfa.org.hk/english/leg_reg/leg_reg_leg/leg_reg_leg.html.

Nonstatutory Elements

The Hong Kong Association of Banks, which was created by the *Hong Kong Association of Banks Ordinance*, in 1981, provides a framework for the government to exchange views with the banking sector for the further development of the industry.

The Hong Kong Securities Institute was formed in 1997 as a professional body to raise the standards of securities and finance practitioners in Hong Kong.

The Hong Kong Investment Funds Association, established in 1986, represents the fund management industry of Hong Kong, and aims at fostering the development of the industry in Hong Kong, while maintaining Hong Kong's competitiveness as a major fund management center in Asia and enhancing the professional standards of the industry.

The Hong Kong Federation of Insurers (HKFI), a self-regulatory body of insurers, was established in 1988 to advance and promote the development of the insurance business in Hong Kong. The Insurance Agents Registration Board was established under the HKFI for the registration of agents and for dealing with complaints about agent malpractice. The Insurance Claims Complaints Bureau was established in 1990 to provide a speedy and inexpensive avenue for resolving claims disputes arising from personal insurance.

Institutional Structure of the Regulators

Hong Kong's financial regulatory system can be characterized as an institutional system with functional characteristics, in which the following individuals and entities have a role.

Financial Secretary of Hong Kong

The Financial Secretary, appointed by the Chief Executive of Hong Kong, oversees policy formulation and implementation of financial, monetary, and economic policies.

All four regulatory authorities—the HKMA, MPFA, OCI, and SFC—are subject to the supervision of the Financial Secretary of the HKSAR Government in terms of achieving the policy objectives set by the Financial Secretary, appointment of the chief executives and independent advisory committees, business and budget plan approval, financial reporting and auditing, and coordination of resources.

In addition, the Financial Secretary chairs and participates in the principal coordinating committees dealing with financial stability.

Hong Kong Monetary Authority (HKMA)

The HKMA acts as the central bank of Hong Kong, with responsibility for maintaining currency and financial stability. The HKMA has four main functions: maintaining the stability of the Hong Kong dollar, promoting the safety of Hong Kong's banking system (through the regulation of banking and deposit-taking businesses and the supervision of authorized institutions), managing Hong Kong's official reserves, and maintaining and developing Hong Kong's financial infrastructure.[13] The HKMA maintains currency stability and promotes the efficiency, integrity, and development of the financial system, which is generally consistent with the roles undertaken by central banks around the world.

The supervisory approach of the HKMA is based on a policy of continuous supervision through on-site examinations, off-site

[13] HKMA Annual Report 2007, www.info.gov.hk/hkma/eng/public/ar07/pdf/04_about_hkma.pdf.

reviews, prudential meetings, cooperation with external auditors, and sharing information with other supervisors.

The HKMA may, under delegated authority from the Financial Secretary, use the Exchange Fund to affect the exchange value of Hong Kong's currency, and actively manages the fund's assets. These are held mainly in the form of marketable, interest-bearing instruments, and equities in certain foreign currencies.

The HKMA has a high degree of autonomy in its pursuit of stated policy objectives determined by the government.

The HKMA carries out the day-to-day administration of the Deposit Protection Scheme (DPS) on behalf of an independent Deposit Protection Board (the Board), whose functions are confined to the assessment and collection of contributions, investment of funds, and paying compensation to depositors in the event of a bank failure. The HKMA implements the decisions of the Board.

The Chief Executive of the HKMA is appointed by the Financial Secretary, who is advised by the Exchange Fund Advisory Committee (EFAC) on matters relating to the control of the Exchange Fund and on the operation of the HKMA. The Financial Secretary is the ex officio Chairman of EFAC, and the other members of EFAC are appointed by the HKSAR Chief Executive. Chaired by the Financial Secretary, the Banking Advisory Committee and the Deposit-taking Companies Advisory Committee established by the Banking Ordinance advise on matters relating to that ordinance, in particular those relating to the business activities of authorized institutions.

The operating and staff costs of the HKMA are charged to the Exchange Fund. The Exchange Fund derives most of its income from its investment activities, although revenue also accrues from license fees paid by AIs, rental payments from tenants, and custodian and transaction fees from users of the HKMA's Central Moneymarkets Unit. The HKMA is accountable to the Financial Secretary. The HKMA's annual budgets and strategic plans are approved by the Financial Secretary on the advice of EFAC, and certain of the HKMA's powers are exercisable only after consultation with the Financial Secretary.

Securities and Futures Commission (SFC)

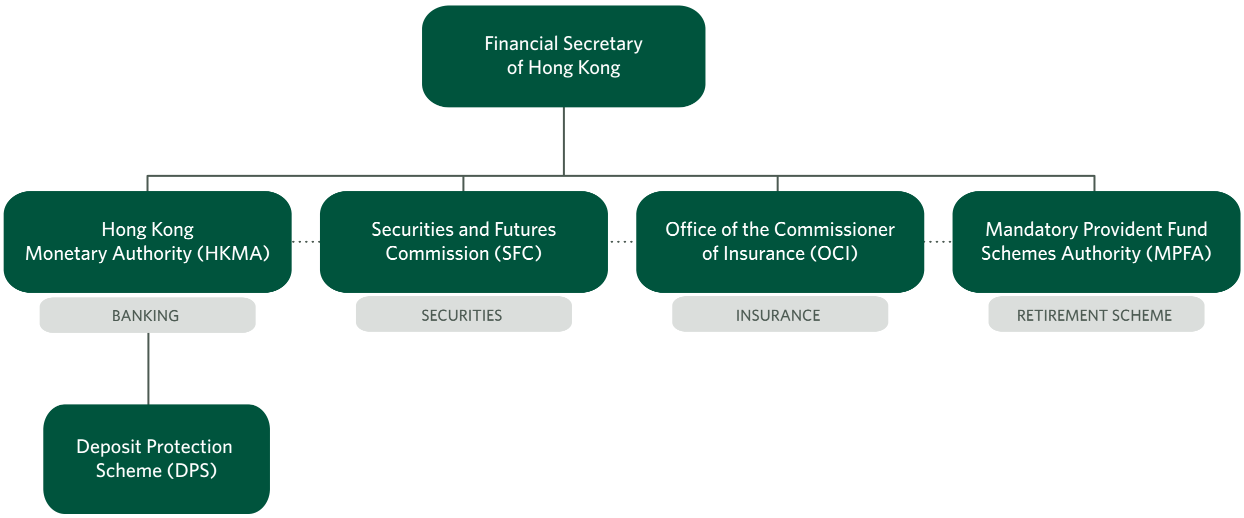
The SFC is an autonomous statutory body responsible for administering the laws governing the securities and futures markets in Hong Kong and facilitating and encouraging the development of these markets. Within the regulatory framework, the SFC also has regulatory oversight of Hong Kong Exchanges and Clearing Limited (HKEx) and its subsidiaries, namely the Stock Exchange of Hong Kong, the Hong Kong Futures Exchange, and three recognized clearinghouses. The SFC works closely with HKEx in listing regulations and supervision of the listed companies.

The constitution and proceedings of the 14-member SFC Board are defined by the *Securities and Futures Ordinance*. All members of the Board are appointed by the HKSAR Chief Executive for a fixed term.[14] All important policies and decisions are approved by the SFC Board.

The SFC generates income from fees raised from regulated entities, and from interest, dividend, and investment income from various financial instruments. It is subject to budgeting, plan approval, and monitoring by the Financial Secretary.

[14] www.sfc.hk/sfc/html/EN/aboutsfc/corporate/governance/governance.html.

FIGURE 2. The Financial Services System Regulatory Structure, Hong Kong



Note: Dotted lines indicate a cooperative relationship.

Office of the Commissioner of Insurance

The Insurance Authority (IA) is responsible for regulation and supervision of the insurance industry in Hong Kong. The Office of the Commissioner of Insurance (OCI) operates under the Financial Services and the Treasury Bureau of the Hong Kong Special Administrative Region Government.[15] The principal functions of the IA are to ensure that the interests of policyholders or potential policyholders are protected, and to promote the general stability of the insurance industry, that is, authorization of insurers, regulation of insurers and insurance intermediaries, and liaison with the insurance industry.

Similar to other regulatory authorities, the OCI received government funding upon its initial establishment. Since the OCI is within the government structure, it receives public funds through the annual government budget. It is subject to budgeting, plan approval, and monitoring by the Financial Secretary.

Mandatory Provident Fund Schemes Authority (MPFA)

The structure of the MPFA consists of a Management Board, which oversees various aspects of the MPF System and which is advised by two statutory committees, the MPF Schemes Advisory Committee, and the MPF Industry Schemes Committee. The Management Board is the governing body of the MPFA. There are at least 10 directors appointed by the Chief Executive of the HKSAR.

15 There are two branches under the Treasury Bureau. The policy responsibility of the Financial Services Branch is to maintain and enhance Hong Kong's status as a major international financial center, ensuring, through the provision of an appropriate economic and legal environment, that Hong Kong's markets remain open, fair, and efficient. While market regulatory functions are performed by independent statutory regulators, the Financial Services Branch facilitates and coordinates initiatives to upgrade overall market quality and to ensure that Hong Kong's regulatory regime meets the needs of modern commerce.

The MPFA generates income from fees raised from regulated entities, and from interest, dividend, and investment income from various financial instruments. It is subject to budgeting, plan approval, and monitoring by the Financial Secretary. The MPFA is required to submit a draft corporate plan and a budget of estimated expenditures to the Financial Secretary for approval before the start of each financial year. It is also required to deliver an annual report.

Figure 2 provides a graphic depiction of the relationship among the above-mentioned institutions.

Enforcement

The HKMA closely supervises authorized institutions (AIs) to ensure their compliance with the *Banking Ordinance* and to promote proper standards of conduct and sound and prudent business practices. In the case of misconduct, the HKMA has various supervisory powers, including, in extreme cases, revocation of an AI's license. The *Banking Ordinance* creates a variety of criminal offenses for failure to comply with its provisions and, in serious cases of noncompliance, the HKMA can recommend that the Department of Justice prosecute an AI's directors, chief executive, or managers, as appropriate. If a bank supervised by the HKMA is facing difficulties, the HKMA can assist in a number of ways. It can give directions (for example, to stop taking large deposits), appoint an adviser to the AI, or appoint a manager of the AI (in which event the Board of the AI will automatically be removed). The HKMA, under delegated authority from the Financial Secretary, acts as the lender of last resort (LOLR) and, under its publicly available LOLR policy, can lend if the preconditions for LOLR support are met against specified types of collateral. The Exchange Fund can also be used to prevent problems of individual AIs from worsening and spreading to other parts of the banking system, if there is a danger of systemic crisis, contagion, or other problems or potential problems.

The *Banking Ordinance* mandates no specific statutory responsibility for the HKMA with respect to consumer protection. Its main responsibility under that ordinance is to ensure that AIs are financially sound and prudently managed. However, the HKMA does require AIs to handle customer complaints properly and, if a customer complaint against an AI raises an issue of supervisory concern in the context of the sound and prudential management of AIs, the HKMA will follow up on that complaint. The HKMA cannot, however, intervene in an AI's commercial decisions, arbitrate disputes between AIs and their customers, or order AIs to pay compensation to their customers.

The SFC closely monitors the activities of the market and intermediaries to combat misconduct that jeopardizes the interests of investors. It can take regulatory actions, including disciplinary or legal proceedings against the parties concerned. For misconduct, manipulation, or similar actions in the market, the SFC monitors the daily trading, reviews the market, investigates fraud and unlawfulness, and revokes licenses. It may ultimately proceed to court with prosecution.

The OCI seeks to ensure that complaints are handled properly by the insurer or self-regulatory body. However, the OCI has no statutory power to intervene in commercial disputes among insurers, insurance intermediaries, and policyholders. The OCI, nevertheless, maintains a monitoring role to ensure that the complaints are properly handled in accordance with the rules and regulations of the self-regulatory framework established under the ICO.

The overriding objective of enforcement by the MPFA is the protection of employees' rights and benefits, and upholding the integrity and credibility of the MPF system.[16] To achieve this objective, the MPFA may apply a number of enforcement measures against noncompliant employers.

Framework for Domestic Coordination

There are two high-level coordination committees in Hong Kong. The first is the Financial Stability Committee, which monitors banking, securities, and derivatives markets for financial stability, and deals with issues and developments with cross-market and systemic implications. It is chaired by the Secretary for Financial Services and the Treasury, and includes representatives from the HKMA, OCI, and SFC. The Committee meets monthly. The second is the Council of Financial Regulators, which provides a forum for discussion of medium- and longer-term structural issues. Its terms of reference include facilitation of coordination and cooperation among regulators, enhancement of information sharing, minimization of duplication or gaps in regulation or supervision, and review of international developments in financial sector regulators. It is chaired by the Financial Secretary and includes representatives from the HKMA, MPFA, OCI, SFC, and the Financial Services and Treasury Bureau. The Council meets quarterly.

The four supervisory agencies have signed a series of Memoranda of Understanding (MoUs) to further enhance cooperation on regulation, supervision, exchange of information, and mutual assistance to ensure the fairness and efficiency of the markets. In addition, they have signed MoUs or formulated other forms of cooperation with other Hong Kong institutions on specific issues. For example, the HKMA administers the deposit protection scheme on behalf of the Hong Kong Deposit Protection Board, and the SFC has signed an MoU with Hong Kong Exchanges and Clearing Limited, regarding the listing and surveillance of the stock and futures market.

International Coordination

The dynamics unleashed by financial services convergence, globalization, and growth of financial conglomerates continue to drive financial supervisors and regulators to seek mechanisms to cooperate and coordinate worldwide. Hong Kong's regulatory authorities are actively strengthening coordination and cooperation with overseas authorities and institutions, in the areas of cross-border and cross-sector supervisory cooperation, exchange of information, and investigatory assistance. Hong Kong maintains a close working relationship with its counterparts in China. For example, the HKMA entered into an MoU with the China Banking Regulatory Commission in 2003 when the Commission was first established, and the HKMA also cooperates with the People's Bank of China (PBC) on various matters. Meetings are held regularly at both the management and working levels, with exchange of opinions and cooperation on a wide range of subjects such as banking supervision, monetary and financial issues, market development initiatives, and staff training.

Hong Kong has adopted many international regulation principles and standards.

[16] www.mpfa.org.hk/english/enforc/enforc.html.

It is a member of the Bank for International Settlements, a participant in the Basel Committee on Banking Supervision's Policy Development Group, the International Liaison Group, the Working Group on Liquidity, and the Working Group on Definition of Capital, and is a member of the Executives' Meeting of East Asia and Pacific Central Banks.

Hong Kong agencies have bilateral agreements with supervisors in Singapore, Thailand, and other jurisdictions. The agreements are primarily nonbinding and based on mutual cooperation. Hong Kong supervisors also participate in "colleges of supervisors," providing another layer of cooperation and coordination.

Please refer to the chart of international coordination activities and organizational participation on page 234.

Current Issues

The development of China's economy and financial markets has stimulated the interaction and cooperation between China and Hong Kong. However, the Hong Kong financial institutions that want to do business in China need to understand the regulatory and legal environment there, which is changing very rapidly and differs from that in Hong Kong.

Such developments affect the regulators differently, given their different focuses. As the regulator of the banking industry and the guardian of the monetary system in Hong Kong, the HKMA tries to balance financial innovation and financial stability. On the other hand, the SFC emphasizes best practices and development of corporate governance. Furthermore, the OCI and MPFA are more cautious about protecting the interests of the public investors.

ACRONYMS AND ABBREVIATIONS

AIs	Authorized institutions
DPS	Deposit Protection Scheme
EFAC	Exchange Fund Advisory Committee
HKEx	Hong Kong Exchanges and Clearing Limited
HKFI	Hong Kong Federation of Insurers
HKMA	Hong Kong Monetary Authority
HKSAR	Special Administrative Region of the People's Republic of China (Hong Kong)
IA	Insurance Authority
ICO	Insurance Companies Ordinance
LOLR	Lender of last resort
MoUs	Memoranda of Understanding
MPF	Mandatory Provident Fund
MPFA	Mandatory Provident Fund Schemes Authority
OCI	Office of the Commissioner of Insurance
ORSO	Occupational Retirement Schemes Ordinance
PBC	People's Bank of China
SFC	Securities and Futures Commission

MEXICO

Market Description

The total assets of Mexico's financial system are approximately 67 percent of gross domestic product (GDP). Commercial banks account for approximately 55 percent of these assets, followed by pension funds, with 13 percent.

Mexico's banking sector (42 commercial banks) is highly concentrated, with the seven largest banks accounting for approximately 84 percent of all bank assets. Foreign financial institutions own approximately 82 percent of total bank assets, including the five largest banks. The majority of financial institutions belong to a financial group, which is formed by a financial holding company controlling at least two of the following institutions: a commercial bank, a brokerage house, an insurance company, or other credit auxiliary institutions.[1]

In addition, there are 18 pension fund operators, 83 mutual fund management companies, 6 government-owned development banks,[2] 94 insurance companies, 10 bond companies, 32 brokerage houses, 39 regulated non-bank banks, and 224 credit auxiliary organizations.

Background

The current Mexican financial regulatory structure can be described as an institutional system, and has evolved in response to a series of financial and economic crises. Prior to the creation of the "multiple bank" entities in the mid-1970s, there were different types of specialized banks (for example, savings banks and mortgage banks) aimed at satisfying the needs of more specific types of consumers, as opposed to most current financial institutions, which operate under a universally oriented banking system.

In 1982, commercial banks were nationalized after a major financial crisis, the result of falling oil prices, rising interest rates, a high fiscal deficit, and a generalized external debt bailout.

During that decade, banks were subject to deposit and lending rate controls, and high reserve requirements prevailed. High fiscal deficits and difficulties in accessing foreign financing forced banks to limit their business mostly to public sector lending. As a result, credit to the private sector decreased during most of the 1980s. The nationalization of banks and a high absorption of savings by the public sector, had important implications for the financial system and credit risk management policies. Government supervisory expertise was undermined since bank liabilities were perceived as a direct government debt. Thus, incentives to monitor bank performance eroded. Supervisory and regulatory functions were oriented toward satisfying a series of accountancy criteria, rather than a risk management approach.

In the late 1980s, the government embarked on an ambitious financial liberalization and comprehensive deregulation process. Both borrowing and lending rates were deregulated, reserve requirements were eliminated, and the direct (politically-oriented rather than financially-viable) credit allocation directives were abolished.

---

1 Examples of credit auxiliary institutions include financial leasing companies, factoring companies, warehouses, money exchange houses, and credit unions.

2 Development banks are established for special purposes, such as financing of foreign trade, housing, or agriculture.

In addition, in the early 1990s, the government sold the former commercial banks back to the private sector.

The financial liberalization, the signing of the North American Free Trade Agreement (NAFTA) in the early 1990s, and a favorable macroeconomic framework, partly sustained by a quasi-fixed exchange rate policy, induced a large volume of predominantly short-term capital inflows into the Mexican economy. As a result, bank foreign currency liabilities increased rapidly, and the current account deficit reached 7 percent of GDP.

The combination of financial deregulation, unprecedented availability of resources for lending to the private sector, and a weak regulatory and supervisory framework, resulted in mounting problems in the banking system. For example, during 1989–94, bank loan portfolios grew at an average annual rate of more than 30 percent in real terms, and bank loans to the private sector increased from 10 percent of GDP to almost 40 percent.

In early 1994, the leading presidential candidate was assassinated, an event coincidental with the U.S. Federal Reserve Board's tightening of its monetary policy. Both actions produced large outflows of capital and precipitated the devaluation of the peso in December 1994, resulting in a large hike in both inflation and interest rates. A deep recession followed, and the fall of real disposable income sharply limited borrowers' capacity to service their debts. As a result, many depositors either withdrew their resources from the Mexican financial system or asked for higher borrowing interest rates to compensate for inflation. As a result, some banks lost their capital, others required government intervention, and many were merged with larger, more capitalized banks.

During the years that followed the 1994 banking crisis, a series of legal reforms were implemented, including the strengthening of bank capitalization rules in accordance with Basel I, and the removal of all of the remaining limits on foreign shareholding in banks. Deposit insurance limits on the protection of bank savings were introduced, and financial regulation and supervision was revamped to allow for a comprehensive risk-oriented approach. Other measures included the operation of credit bureaus; new regulations for disclosure and transparency of financial information; the implementation of prompt corrective actions and an early-warning system; a banking resolution regime; updated regulations for credit rating agencies and external auditors; reallocation of powers of the Ministry of Finance and Public Debt (SHCP) and the National Banking and Securities Commission (CNBV), so the latter became responsible for the full regulatory cycle of banking and brokerage houses (that is, the licensing, supervision, and license-revoking process); strengthening the cooperation with home financial authorities for purposes of supervision; and, more recently, the initial implementation of Basel II.

Bank credit to the private sector began to recover in 2004, when banks were finally able to raise sufficient capital to finish improving their balance sheets. By 2006, credit to households was growing, in real terms, above 40 percent.

To promote more competition and facilitate the access of more people to financial services, several new bank licenses were granted to commercial retail chains in 2006 and 2007, and new licenses were granted to other types of financial institutions, thus increasing the number of financial competitors, products, and services available in the financial market. Also, other financial companies known as non-bank banks (leasing, factoring, and non-bank banks) that provide credit but do not receive deposits from the public were deregulated.[3]

Statutory Framework

The *Bank of Mexico Law* (1993) states that the Bank is autonomous, its purpose being to maintain the currency's purchasing power, and to promote the sound development of the financial system and the integrity of the payment system. The Bank of Mexico is also a lender of last resort.

The *National Banking and Securities Commission Law* (1995) established the National Banking and Securities Commission as a specialized agency (*organo desconcentrado*, thus granted technical and operational autonomy) of the Ministry of Finance and Public Debt. It is charged with prudential supervision and regulatory responsibilities over financial intermediaries (with the exception of insurance companies, bond companies, and pension funds), in order to ensure their stable functioning and the sound development of the financial system.

The *Payment System Law* (2002) regulates payment systems that are regarded as systemically important. This law recently granted additional powers to the Bank of Mexico to regulate and supervise payment systems.

The *Credit Institutions Law* (1990) regulates commercial and development banks, including the banking resolutions regime.

The *Financial Groups Law* (1990) regulates the organization of financial intermediaries within a financial group.

The *Auxiliary Credit Organizations Law* (1985) regulates foreign exchange firms, credit unions, and other financial companies that provide credit and belong to a bank.

The *Law of Banking Savings Protection* (1998) established the Institute for the Protection of Banking Savings (IPAB), a federal deposit insurance scheme.

The *Securities Market Law* (2005) regulates the activities and operations of entities participating in the securities market, promoting the sound development of the sector and consumer protection.

The *Mutual Funds Law* (2001) regulates the operations of mutual funds.

The *Insurance Companies Law* (1935) regulates the organization and functioning of insurance companies.

The *Financial Services and Transparency Law* (first passed in 2004, and revised in 2007) empowers financial authorities to regulate specific issues concerning banking services and consumer protection, such as contracts, bank statements, receipts, advertising, disclosure of annual percentage rates, interest rates, and bank fees.

The *Protection and Defense for Financial Services Users' Law* (1999) regulates financial services consumer rights. It established the National Commission for the Protection and Defense of the Financial Services Users, which acts as a mediator between financial institutions and the general public.

The *Retirement Funds System Law* (1996) regulates (mandatory) pension funds. It also established the National Commission for Retirement Savings.

[3] Two typical schemes operate for non-bank banks. In the first one, provided that they do not belong to a holding financial institution, they are not regulated by the National Banking and Securities Commission. However, when these financial companies actually belong to a banking group, they remain under the supervisory and regulatory scope of the above-mentioned financial sector authority.

Nonstatutory Elements

No nonstatutory elements have been noted.

Institutional Structure of the Regulators

The current Mexican financial regulatory structure can be described as an institutional system. Seven entities are in charge of regulating and supervising the financial system, as explained below.

Ministry of Finance and Public Debt (SHCP)

The SHCP is responsible for the design of the overall financial sector, including its legal framework, and for the coordination of the different supervisory commissions. In this respect, the ministry retains considerable influence over financial supervision because the CNBV, CNSF, and CONSAR are specialized agencies of the SHCP. The Secretary of Finance of the SHCP appoints the presidents of the CNBV, CNSF, CONDUSEF, and CONSAR.

Bank of Mexico

The Bank of Mexico is Mexico's central bank. Created in 1925, it became autonomous in 1994. It is headed by a board composed of a Governor and four Deputy Governors. Board members serve staggered eight-year terms (six for the Governor). The Governor and Deputy Governors are appointed by the President and ratified by the Senate. The Bank of Mexico has its own revenue (seigniorage), and its budget is not submitted to the Congress for approval. However, it must submit annual reports to the Congress. It is also the lender of last resort.

National Banking and Securities Commission (CNBV)

The CNBV was formed in 1995 as a result of a merger of the National Banking Commission and the National Securities Commission. Its main responsibilities are the issuance of prudential regulation and the supervision of all financial intermediaries (with the exception of insurance companies, bond companies, and pension funds). The CNBV's President is appointed by the Secretary of Finance. The *National Banking and Securities Commission Law* grants technical and operational autonomy to the CNBV, so it can perform its duties with minimal external interference from other authorities.

National Insurance and Bond Companies Commission (CNSF)

The CNSF was established in 1989 and is the prudential regulator and supervisor for insurance and bond companies. The President of the Board of Governors of the CNSF is appointed by the Secretary of Finance.

National Commission for the Retirement Savings System (CONSAR)

CONSAR was established in 1994 and is the prudential regulator and supervisor for pension fund managers. The President of the Board of Governors of CONSAR is appointed by the Secretary of Finance.

National Commission for the Protection and Defense of Financial Services Users (CONDUSEF)

CONDUSEF was established in 1999 and is responsible for consumer protection. The President of the Board of Governors of CONDUSEF is appointed by the Secretary of Finance.

To ensure a proper functioning and coordination of duties among the abovementioned authorities, each Commission's Board of Governors is composed of (top) officials from the Ministry of Finance and Public Debt and the Bank of Mexico, with the participation of representatives of the other Commissions. However, the CONDUSEF and the CONSAR boards also include members from (trade) unions and chambers from the private sector.

The CNBV, CNSF, CONDUSEF, and CONSAR receive part of their financing through the government's annual budget, which is approved by Congress, and three commissions (all except CONDUSEF) charge authorized firms' fees, the income from which is transferred back to the SHCP.

Institute for the Protection of Banking Savings (IPAB)

IPAB was established in 1999 and is in charge of deposit insurance in Mexico. IPAB's Board of Governors is composed of the Minister of Finance, the Governor of the Bank of Mexico, the CNBV's President, and four nongovernment officials designated by the Executive and approved by at least two-thirds of the Senate. The board designates an Executive Secretary, who is in charge of the administration of the institute. IPAB's Deposit Insurance provides coverage of 1,615,134 pesos (US$158,731) per legal person and per bank.

The Executive Secretary of IPAB and the President of each Commission are appointed by the Minister of Finance. IPAB's budget is part of the government's annual budget, which is approved by the Congress.

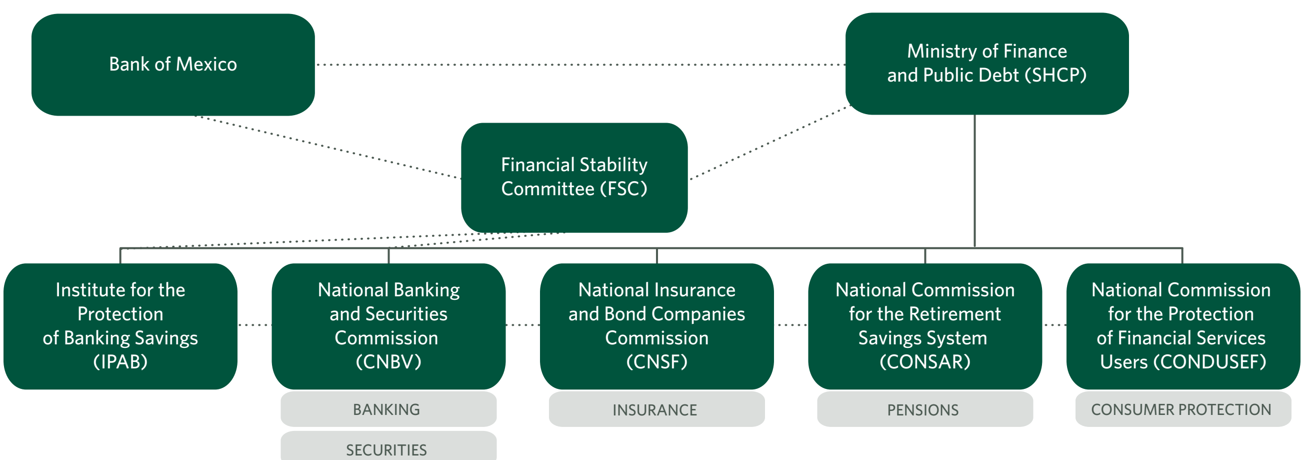
Figure 3 provides a graphic depiction of the relationship among the above-mentioned institutions.

Enforcement

The Bank of Mexico has the power to impose fines on financial intermediaries that do not comply with the central bank's regulations.

The CNBV carries out both on-site inspections and off-site analysis of financial entities under its regulatory and supervisory scope. Taking into account the internationalization of the banking system, the CNBV has entered into several Memoranda of Agreement with foreign supervisors, to ensure effective surveillance and enforcement cooperation. In addition, there is a system in place for early warning and

FIGURE 3. The Financial Services System Regulatory Structure, Mexico



Note: Dotted lines indicate a cooperative relationship.

prompt corrective actions that provides for a series of actions and restrictions to financial institutions operations that do not comply with minimum capital requirements.[4] The CNBV also has the power to impose fines and issue regulations. When necessary, other agencies (such as the Bank of Mexico, the IPAB, and the SHCP) are consulted on developments.

The CNSF carries out on-site inspections of insurance and bond companies, and can impose sanctions if intermediaries do not comply with the regulations.

The CONSAR has various enforcement powers over pension fund operators. If the CONSAR is concerned about the activities of a pension fund provider, it can require a report from the provider's board, intervene directly in the fund, or move funds from the firm to another fund or to the Bank of Mexico for the duration of the investigation.

The IPAB can take enforcement action when required. In conjunction with the SHCP and the CNBV, the IPAB can commence banking resolution, pursue bankruptcy if necessary, liquidate assets, create a bridge bank, and ultimately pay guaranteed liabilities.

Framework for Domestic Coordination

All supervisory Commissions and IPAB boards include representatives of each other and of the SHCP and the Bank of Mexico.

In addition to the coordination fostered by the above linkages, representatives from the Bank of Mexico, the SHCP, the Commissions, and the IPAB share several formal and informal committees where regulations and other financial matters are discussed and coordinated. All important topics that are presented for approval to the board of any Commission and the IPAB are usually fully discussed and agreed within these committees.

If a financial institution that is "too big to fail" faces a possible crisis of liquidity or solvency, bank resolution can be dealt with by a Financial Stability Committee (FSC) that is composed of the principals of the Bank of Mexico, the CNBV, the IPAB, and the SHCP. The FSC has yet to be tested via an intervention in the case of a systemically important financial institution. In the case of a financial institution failure, the SHCP would lead, supported by the Bank of Mexico, the CNBV, the IPAB, and other agencies.

International Cooperation

Please refer to the chart of international coordination activities and organizational participation on page 234.

Current Issues

Congress recently approved modifications to the *Credit Institutions Law* aimed at improving the competitiveness of the banking sector and addressing prudential issues related to banks linked to commercial retail chains. The main changes were as follows: (a) reductions in capital requirements for banks—minimum capital is now set in accordance with each bank's activities; (b) restrictions to banks' operations with related commercial retail chains; and (c) changes to the regulations of banks' operations, with third parties used to channel some bank services.

Authorities are working on additional modifications to update the bankruptcy regime for credit institutions.

---

4 For a list of prompt corrective action steps, see www.ipab.org.mx/english/02proteccion/02_04_acciones.htm.

ACRONYMS AND ABBREVIATIONS

CNBV	National Banking and Securities Commission (Comisión Nacional Bancaria y de Valores)
CNSF	National Insurance and Bond Companies Commission (Comisión Nacional de Seguros y Finanzas)
CONDUSEF	National Commission for the Protection and Defense of Financial Services Users (Comisión Nacional para la Protección y Defensa de los Usuarios de Servicios Financieros)
CONSAR	National Commission for the Retirement Savings System (Comisión Nacional del Sistema de Ahorro para el Retiro)
FSC	Financial Stability Committee
GDP	Gross domestic product
IPAB	Institute for the Protection of Banking Savings (Instituto para la Protección al Ahorro Bancario)
SHCP	Ministry of Finance and Public Debt (Secretaría de Hacienda y Crédito Público)

THE FUNCTIONAL APPROACH

The functional approach is one in which supervisory oversight is determined by the business that is being transacted by the entity, without regard to its legal status. Each type of business may have its own functional regulator.

Brazil · France · Italy · Spain

BRAZIL

Market Description

Brazil's banking sector comprises approximately 2,500 firms[1] and represents about 6 percent of the country's gross domestic product (insurance services included). Banking institutions provide services to the public through branches, post office outlets, electronic banking, and correspondents.[2]

By 2007, there were about 18,000 bank branches, a 12 percent increase over 1996. Electronic services are growing more rapidly than traditional branch banking, due not only to enhancements in technology, but also to reorganization in response to mergers and acquisitions. Services being provided by correspondents have also been experiencing growth in excess of traditional branch banking. In 2006, approximately 1,450 branches were opened, while within the same time period, 6,800 correspondents were opened.

The securities market is growing rapidly, albeit from a relatively low base. The volume of primary capital market offers, including stocks, debentures, and promissory notes registered with the Securities and Exchange Commission (CVM), totaled R$48.5 billion in 2005, compared to R$16.3 billion in 2004. The 197 percent growth was driven primarily by debenture issues. The easing of monetary policy reinforced investor expectations about the economy. Since then, the volume and total value of private issues of stocks and private bonds have grown rapidly, and this may be expected to continue.

Approximately 160 companies comprise the insurance, (open) private pension,[3] and capitalization market. Insurance companies make up the majority (72 percent), 17 percent are entities exclusively dedicated to offering open private pension schemes, and 11 percent are dedicated to capitalization plans. In 2007, total premiums within the insurance sector reached approximately R$74 billion, making Brazil the largest insurance market in Latin America, and there were more than 370 closed pension funds holding R$260 billion in assets.

Background

The Brazilian regulatory structure is characterized as functional system with institutional aspects. The Brazilian financial supervisory system has developed gradually, primarily during the second half of the 20th century, and mostly in response to various pressures, financial crises, and changes in the nature of financial services over time. In the mid-1960s, following implementation of the macroeconomic stabilization plan, called the Government Plan for Economic Action, a need for restructuring the financial system was recognized. This led to passage of the *National Financial System Law* (*Law 4.595/64*), which is still the principal legislation underpinning the Brazilian financial markets. The

---

[1] These firms include holding companies and savings, commercial, development, and investment banks (Unicad [Information System for Entities of Interest to the Central Bank], September 2007).

[2] A correspondent is a bank that accepts deposits of, and performs services for, another bank. In most cases, the two banks are in different cities, but they can also be in different countries.

[3] There are two types of pension funds in Brazil: closed (entidades fechadas) and open (abertas). Closed funds are occupational pension plans, organized as pension funds, sponsored by corporations and, until recently, only for organizations with more than 100 employees. They are nonprofit organizations. The open funds can be either for-profit or nonprofit organizations, although the majority are for-profit organizations run by commercial banks and insurance companies. The closed funds are regulated by the Complementary Pension Secretariat (SPC) and the open funds by the Superintendence of Private Insurance (SUSEP).

act established the National Monetary Council (CMN), through which all major monetary and financial resolutions are issued, and which includes the Minister of Finance, the Minister of Planning, and the Governor of the Central Bank.

The *National Financial System Law* also created the Brazilian Central Bank (BCB). The BCB is an independent federal institution that took over the functions of a monetary authority. These functions were previously performed by the Currency and Credit Superintendence (SUMOC),[4] the Bank of Brazil (BB),[5] and the National Treasury.[6] Although some improvement was achieved through the creation of a formal Central Bank, the institutional process was not complete because the BCB was not given the full authority and responsibilities of a central bank. The BCB became the currency-issuing bank, but acted according to the needs of the BB. The BCB was the bank of banks but was not the only holder of deposits from financial institutions, since many institutions placed their voluntary reserves in the BB. Nonetheless, the BCB was the government's financial agent in charge of managing the federal public debt. It was not the cashier to the National Treasury since this was also a function of the BB.

In the 1960s and 1970s, *Law 6385/76* mandated reforms aimed at fostering the emergence of a capital market and enhancing supervision through the 1976 establishment of the Securities and Exchange Commission (CVM).

By the 1980s, Brazil was experiencing rapid inflation and a prolonged economic crisis, leading to a drastic fall in demand for bank loans, increases in liquidity, and significant decreases in credit volume. However, financial institutions succeeded in maintaining relatively high profits due to income from non-interest-bearing deposits. While bank assets became increasingly concentrated in highly liquid government securities, the government abolished the charter requirement for setting up new institutions and authorized the incorporation of multipurpose banks, which led to an increase in the number of banks.

Then, in 1985, the government further reorganized the financial supervisory structure. The main change was the removal of the financial linkages and overlapping functions among the BCB, the BB, and the National Treasury. In 1987, the automatic transfer of funds from the BCB to the BB was eliminated, which had hampered the BCB's management. Through 1988, full monetary authority was progressively transferred from the BB to the BCB, while atypical activities carried out by the BCB (such as those related to economic incentives and administration of public debt) were transferred to the National Treasury.

The 1988 Constitution continued the clarification of the BCB's role, explicitly assigning to it the responsibility of issuing

---

4 The SUMOC, created in 1945, was responsible for monetary control, and it laid the foundation for a central bank. Decisions related to reserve requirement ratios for commercial banks, discount rates (linked to development funds) and financial assistance for liquidity, and the interest rate on bank demand deposits were established by the SUMOC. It was also the commercial bank's supervisor and the agency responsible for managing the exchange policy.

5 The BB had an important role as a government bank, controlling foreign trade and foreign exchange operations, executing foreign exchange operations on behalf of public sector enterprises and the National Treasury, and collecting reserve requirements and voluntary deposits of commercial banks.

6 The National Treasury was the currency-issuing authority, part of a complex issuance process that involved several other governmental entities.

currency and specifying that its board, which is appointed by the President, requires Senate approval. The 1988 Constitution forbade direct or indirect granting of loans to the National Treasury and called for a *Complementary Law of the National Financial System* to replace the *National Financial Systems Law of 1964*.

Brazil experienced further economic strains in the early 1990s. In July 1994, inflation rates reached almost 46 percent per month, and the Real Plan was enacted to cut inflation. A systemic crisis was imminent; seven small banks filed for bankruptcy. In 1995, after 13 other bankruptcies, the BCB intervened at the Banco Economico (a large Brazilian bank) to avoid a bank run. To address this crisis, in late 1995, the government announced a strategy that included a commitment to bear the costs of losses instead of the banks' creditors in order to encourage mergers and acquisitions of the banks facing difficulties.

In response to the bank failures, a further, more fundamental restructuring of the banking system safety net was implemented. Prudential regulations were enacted and supervision was strengthened to ensure safety and soundness of the financial system. In addition, other changes were instituted, including a direct line of liquidity and the creation of a deposit insurance scheme. In April 2002, the Brazilian Payment System was reformed. Under the new system framework, the BCB would not accept negative balances on the reserve accounts of any bank at any time.

As for insurance, Brazil's government has regulated all insurance and reinsurance operations since 1966. It created the National System of Private Insurance, which was formed by the National Private Insurance Council (CNSP), the Private Insurance Superintendence (SUSEP), Brazil RE, companies that operate in private insurance, and qualified brokers. In 1967, the National System of Capitalization was created. In 2003, SUSEP began a modernization process based on the International Association of Insurance Supervisors Core Principles.

In 2007, *Complementary Law 126* eliminated the previous state monopoly on reinsurance. CNSP became the regulator for co-insurance, reinsurance, and retrocession[7] transactions, with regulatory supervision provided by SUSEP. Brazil RE would continue to operate as a local reinsurer only.

Closed pension funds have been regulated since 1977, when these funds were designated as depository institutions. The law was updated in 1998 and 2001 with general rules to define the relationship between the government bodies and their respective pension entities.

Statutory Framework

The *National Financial System Law* (*Law 4.595/64*) is the fundamental law of Brazil's financial system. In effect since 1964, it created the National Monetary Council (CMN) and the Brazilian Central Bank (BCB). The CMN was given the responsibility for formulating monetary and credit policies, and the BCB is responsible for

---

7 Retrocession is the practice of one reinsurance company insuring another reinsurance company by accepting business that the other company had agreed to underwrite. Example: Company "B" has accepted reinsurance from Company "A," and then obtains for itself, on such business assumed, reinsurance from Company "C." This secondary reinsurance is called a retrocession.

executing those policies. Resolutions can be issued without Congressional approval if they comply with the existing law.

Law 6.024/1974 deals with issues of intervention and judicial liquidation. Related to this law is Executive Act Nº 2.321/87, which institutes the Special Temporary System of Administration. Together, they allow the BCB to place companies into administration and remove or replace a company's board of directors.

Law 7.492/1986 defines financial crimes and related penalties. This includes, but is not limited to, unauthorized bond issuances, omission of relevant information, and fraud against the supervisory process. *Law 9.613/1998* defines money-laundering crimes and associated penalties. *Law 9.613* established the Council for Financial Activity Control, which is responsible for the enforcement of anti-money laundering activities.

Law 9.447/1997 increased the formal powers of the BCB, allowing it to take preventive measures, such as requiring capitalization, transfer of shareholder control, and/or stockholder structure reorganization (acquisition, merger, or split-up). Various other legislative actions provide the BCB additional powers and establish standards within the financial services industry.

The main laws that guide the securities industry are the *Securities Law* (*Law 6.385/1976*) and the *Corporation Law* (*Law 6.404/1975*), amended through *Law 9.457/1997* and *Law 10.303/2001*, respectively.

SUSEP was created by Decree-Law 73/1966 and Decree 60.459/1967. These decrees regulate capitalization companies and, along with *Complementary Law 109/2001*, set the guidelines for pension funds, which are supplemented by other laws dealing with SUSEP's prudential functions.

In 1998, Constitutional Amendment 20 provided legislative guidance for complementary pensions. Additional guidelines were addressed in *Complementary Law 109/2001*. Article 74 of this law established the Complementary Pension Council (CGPC) as the primary regulator and the Complementary Pension Secretariat (SPC) as the provisory supervisor.

Public Social Insurance and Social Assistance Ministry Resolution 01/1986 established the oversight for closed pension fund entities. Standards including prudential limits are further described in *Complementary Law 109/2001* and CMN Resolution 3.121/2003.

Nonstatutory Elements

Many Brazilian financial market operators have established self-regulatory mechanisms. For example, for banking activities, the Brazilian Federation of Banks has self-regulation components that include principles of transparency, fair competition, confidentiality, and compliance with formal rules and regulations.

Within capital markets, the National Association of Investment Banks established in 1998 five codes for self-regulation relative to investment funds, public offerings, qualified services to capital markets, private banking activities, and the qualified certification program.

The National Association of Financial Market Institutions was established in 1971, and its members include commercial, universal, and investment banks, as well as stockbrokers and securities distributors. The group has a formal Code of Ethics and formal standards of conduct.

Within the insurance industry, there is a published Code of Ethics of the National Federation of Insurance Companies, which addresses general principles, institutional responsibility, social responsibility, ethics and internal relations, ethics and consumer relations, and fraud and money laundering, and established a Market Discipline and Ethics Council.

Institutional Structure of the Regulators

As noted, the regulatory structure in Brazil is characterized as functional with some institutional aspects, and includes the following entities.

National Monetary Council (CMN)

The CMN is responsible for management of liquidity, protection of the currency, and coordination of monetary, fiscal, and credit policies. It also has supervisory responsibilities that include guiding the allocation of funds by financial institutions, improving financial instruments and institutions, and monitoring financial institution liquidity and solvency.

The CMN has authority to draft regulations implementing the laws enacted by the National Congress. The rules issued by CMN, typically referred to as "Resolutions," must be adhered to by all the members of the financial system, including the BCB and the CVM.

The CMN is composed of the Minister of Finance (Chairman), the Minister of Planning, and the Central Bank Governor, all of whom are appointed by the President of Brazil.

Brazilian Central Bank (BCB)

The BCB is responsible for maintaining national currency purchasing power and monitoring the stability of the financial system. It has the formal authority to supervise all financial institutions and has licensing responsibilities.

As the monetary authority, the BCB acts as the lender of last resort. It has the authority to intervene as necessary and liquidate financial institutions if there is a threat to the safety and soundness of the financial system.

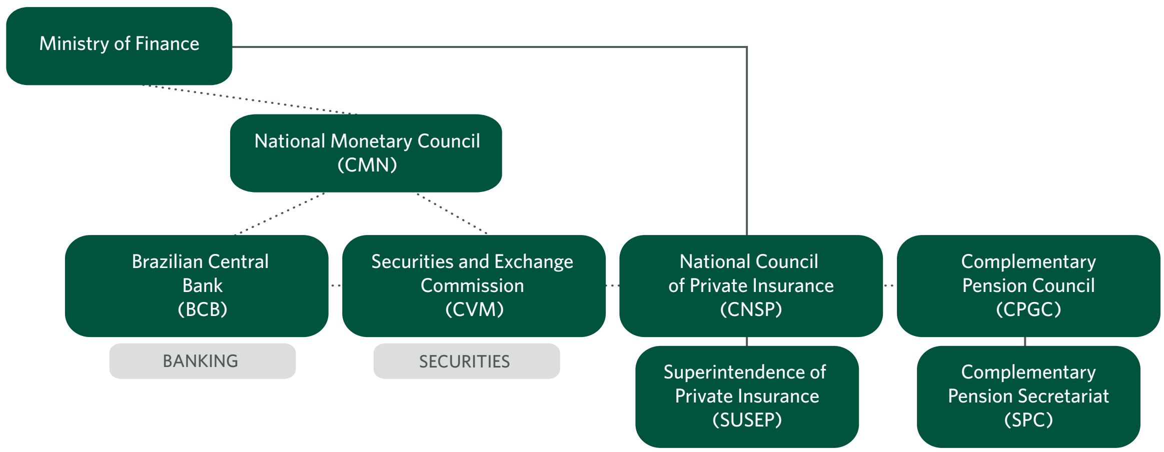
The BCB has seven main areas of operation, each run by a Deputy Governor: (a) administration, (b) bank liquidation and privatization, (c) international affairs, (c) monetary policy, (d) supervision, (e) financial system regulation, and (f) organization and economic policy. The BCB generates income from its activities as monetary policy executor and from the Treasury budget. Any profits are returned to the Treasury and any losses are covered by the Treasury. In 2006, approximately 97 percent of its budget was generated from interest income.

The Securities and Exchange Commission (CVM)

The CVM oversees and supervises the stock market and other securities activities (debentures, commercial papers, stock index futures, stock options, over-the-counter markets). It also supervises the institutions operating in the capital markets and the listed companies. The CVM has the legal duty to protect securities holders against fraudulent issues and/or illegal actions, and to ensure fair trading practices, including access by the public to accurate and relevant information.

One governor and four deputy governors oversee the CVM, all of whom are appointed by the President of Brazil. The CVM is funded through the central government's annual budget; however, on

FIGURE 4. The Financial Services System Regulatory Structure, Brazil



Note: Dotted lines indicate a cooperative relationship.

average, 91 percent of its income is derived from supervision fees, debts, and fines.[8]

National Council for Private Insurance (CNSP)

The CNSP establishes the guidelines and regulations for the private insurance market. It is run by the Minister of Finance (its chairman) and representatives from the Ministry of Justice, the Ministry of Social Security, the BCB, the CVM, and the Superintendent of SUSEP.

Superintendence of Private Insurance (SUSEP)

The SUSEP was created by Decree-Law 73/66 and is directly linked to the Ministry of Finance. It is the executive body of the CNSP, and is also the insurance commissioner, responsible for the supervision and control of the insurance, open private pension funds, and capitalization markets in Brazil.

SUSEP's objectives are to ensure that market participants remain solvent and to promote customer protection. It has four main departments: administration, actuarial techniques, economic control, and supervision. Funds for SUSEP are allocated from the government's annual budget. In 2006, approximately 59 percent of its income was derived from fees and fines collected from supervised institutions. The Complementary Pension General Council supervises closed pension funds in conjunction with the SPC and is funded via receipts from the Treasury.

Figure 4 provides a graphic depiction of the relationship among the above-mentioned institutions.

Enforcement

The Brazilian Central Bank (BCB) has broad powers to take actions to safeguard banking activities and depositors and creditors with the goal to maintain financial stability. These powers include warnings, fines, suspensions, and temporary disqualifications.

[8] CVM Annual Report 2005.

When a situation of noncompliance with minimum capital, net worth requirements, or excess risk is identified, various measures can be taken by the BCB. These measures include warnings, fines, license suspension, and/or temporary disqualification. In addition, the BCB can also require restructuring, the injection of capital, or can liquidate the institution.

The Securities and Exchange Commission (CVM) has similar powers within the securities industry. *Law 6 385/76*, which governs the securities market, states that the CVM shall perform the duties provided for under the law in order to "protect securities holders and market investors… against illegal acts of officers and controlling shareholders of publicly held corporations, or managers of securities portfolios." *Law 6 385* requires that the accounts of listed companies, and other companies regulated by CVM, be audited.

There are a number of applicable requirements under relevant laws and rules that seek to ensure the independence of external auditors in Brazil. In that regard, external company audits may be carried out only by audit firms or independent accounting auditors registered with the CVM. These auditors are subject to the rules of the CVM and the Federal Accounting Council, and also the Independent Auditors' Institute, with regard to professional conduct. The BCB adopts the same procedure for financial institutions. The CVM may impose penalties on auditors and audit firms, including warnings, fines, suspension, or cancellation of authorization or registration, where they acted in breach of the securities or company laws and regulations.

Framework for Domestic Coordination

Coordination between the governor of the BCB and the Minister of Finance occurs through the CMN. Membership of the CMN allows for sharing of information related to supervisory actions of the BCB. Coordination between the BCB and the CVM is based on standards set by the CMN.

In addition, the BCB has two agreements in place with other agencies addressing matters of coordination and cooperation: an agreement between the BCB and the CVM of February 2004, which concerns exchange of information and other activities to better perform respective tasks; and an agreement between the BCB and the SUSEP of July 2005, concerning the coordination of activities and information exchange.

International Coordination

The BCB works closely with other international supervisory agencies and has formal agreements with various countries and territories, including Argentina, Germany, Mexico, Panama, Paraguay, Spain, the Bahamas, the Cayman Islands, and the United States.

Brazil also participates in various international regulatory organizations. Please refer to the chart of international coordination activities and organizational participation on page 234.

Current Issues

Several issues regarding financial system regulation are currently being considered by Brazilian regulators and policymakers. In addition to ongoing efforts relating to Basel II[9] implementation, another area of reform within banking is related to bank-

[9] Basel II created an international standard for banking regulators to use when drafting regulations about how much capital banks need to put aside to guard against financial and operational risks.

ruptcy (*Intervention and Liquidation Law 6.024*). Consideration is being given to how best to align the existing financial system laws with the new corporate bankruptcy law and to achieve better alignment with international practices.

The opening of the insurance market is also under discussion. In January 2007, *Complementary Law 126* eliminated the previous state insurance monopoly. The regulation of co-insurance, reinsurance, and retrocession transactions is now assigned to the CNSP, supervised by the SUSEP. The law authorizes three types of reinsurance companies to operate in Brazil: the local reinsurer, the admitted reinsurer (reinsurer with registered offices abroad and with a representative office in Brazil), and the eventual reinsurer.

Competition within the banking industry is also under review. The BCB has the authority to approve mergers and to investigate conduct. However, the main antitrust authority in Brazil, the Administrative Council for Economic Defense, appointed by the Judiciary, is responsible for ensuring fair competition within the banking sector. To address this overlap of duties and responsibilities, the government presented a bill, currently under consideration by Congress, calling for the Brazilian System of Defense of Competition to oversee mergers of financial institutions only in cases where there is no systemic risk related to the merger. If the merger could impact the soundness of the financial system, the BCB would retain ultimate authority.

Finally, the Competition Protection Code (CPC), established in 1990, is under discussion. From 1990 to June 2007, there was confusion in the marketplace as to the applicability of the CPC to banking consumers. Banks had claimed it was not applicable; however, the Federal Supreme Court ruled against the bank claims and confirmed that the CPC does apply to banking consumers.

ACRONYMS AND ABBREVIATIONS

BB	Bank of Brazil (Banco do Brasil)
BCB	Brazilian Central Bank (Banco Central do Brasil)
CGPC	Complementary Pension Council (Conselho de Gestão de Previdência Complementar)
CMN	National Monetary Council (Conselho Monetário Nacional)
CNSP	National Council of Private Insurance (Conselho Nacional de Seguros Privados)
CPC	Competition Protection Code (Codigo de Defesa do Consumidor)
CVM	Securities and Exchange Commission (Comissão de Valores Mobiliários)
R	Real
SPC	Complementary Pension Secretariat (Secretaria de Previdência Complementar)
SUMOC	Currency and Credit Superintendence (Superintendência da Moeda e do Crédito)
SUSEP	Superintendence of Private Insurance (Superintendência de Seguros Privados)

FRANCE

Market Description

The French financial industry comprises 747 credit institutions, 685 investment firms (including 536 asset management companies), 1,522 insurance entities, and approximately 6,000 investment funds. The industry contributes 4.6 percent of French gross domestic product. The French asset management industry has assets of more than €1.25 trillion (euros).

The domestic market for banking and financial services is highly concentrated, with seven large banking groups holding a market share of 80 to 90 percent. These groups are universal banks, serving retail and corporate clients, and they are active, directly or through subsidiaries, in commercial and investment banking; specialized finance (consumer credit, housing credit, leasing, factoring, payment, credit cards, and so forth); asset management; and insurance. A number of French financial groups maintain an important international presence, with more than 50 percent of all BNP Paribas, Société Générale, and AXA employees located outside of France.

The insurance sector has assets amounting to €1.785 trillion.[1] Independent insurance groups have a market share of more than 80 percent. Banks are not very active in general insurance, but have a larger role in life insurance.

Background

The French regulatory structure can be characterized as a functional system with some aspects of a twin peaks approach, one that has evolved over the years. The Bank of France (BDF), the central bank, has played a central role in both the prudential and supervisory framework since the first French banking law of 1941. In 1967, France was the first European country to establish a specific authority for market supervision, the Market Operations Commission (COB).

The regulatory structure has been modified several times in recent decades to comply with European Union (EU) directives. In 1984, a new *Banking Act* was enacted, following the first EU *Banking Directive*, to establish a single regulatory framework for all banking institutions and activities and to create the Committee of Credit Institutions and Investment Firms (CECEI) and the Banking Commission (CB). In 1996, this Act, along with others, among which the *Act of 1989* on market security and transparency, was amended to implement the EU *Investment Services Directive* and to introduce the concept of investment services and investment firms, and to create the Financial Markets Council (CMF) as the body responsible for supervising financial markets and business codes.

Insurance regulation and supervision were organized in the 1930s within the central government, and were allocated to two independent authorities in 1989.

The framework for financial supervision was further reformed in 2003 to improve the efficiency of the financial regulatory system. The review was not a response to a particular crisis; rather, it was a reaction to the perception that the former structures were complicated and duplicative. The new structure maintains a general distinction between supervisory agencies and the licensing bodies.

Although many institutions were changed as part of the reform process, prudential banking supervision was not

[1] Figures mentioned in this document are drawn from the 2007 annual reports of the Bank of France, the Financial Markets Authority (AMF), and the Insurance and Mutual Societies Supervisory Authority (ACAM).

affected by the reforms of 2003. Prudential supervision remains the task of the CB. The CB is legally separate from the central bank. However, its staff and budget are provided by the BDF. The licensing of credit institutions is a function of the CECEI, a legally independent authority housed within the BDF.

The 2003 reform led to the simplification of the regulatory structure and the merger of a number of institutions, particularly those dealing with securities markets and consumer protection. The *Financial Security Act* of August 2003 established the Financial Markets Authority (AMF). The AMF was the result of the merger of the COB, the CMF, and the Council on the Discipline of Financial Management (CDGF). The AMF is a public agency that has financial autonomy. Its remit is to safeguard investments in financial instruments and in all other savings and investment vehicles, to ensure that investors receive material information, and to maintain orderly financial markets.

Insurance activities are supervised by the Insurance and Mutual Societies Supervisory Authority (ACAM), which is an independent agency. The Ministry of Economy, Finance and Industry (MINEFI) remains responsible for licensing insurance companies. The Committee of Insurance Companies (CEA) was created in 2003. Its purpose is to grant individual authorizations or exemptions applicable to insurance firms and firms underwriting reinsurance.

The 2003 reforms also addressed perceived challenges faced as government agencies sought to improve consultation, cooperation, and coordination. First, the reform created the Advisory Committee on Legislation and Financial Regulation (CCLRF), replacing two existing bodies that separately provided advice on banking and insurance matters.[2] Although the CCLRF is only an advisory body, it must be consulted on draft regulatory and legislative provisions in the fields of insurance, banking, and investment firms. Second, the reform established the Board of Financial Sector Authorities (CACESF). This college of supervisors is designed to enhance cooperation and exchange of information among the leadership of key supervisory agencies. Third, the reforms created formal links among the principal agencies at the level of the board to enhance information sharing, coordination, and high-level policy debate.

Statutory Framework

Since 2000, the legislation dealing with banking activities, investment services, and asset management services has been contained in a single compendium, the Monetary and Financial Code (COMOFI), which is amended each time new provisions are enacted by the National Assembly or by a government decree.

Article L. 611-1: Regulation (2003). This article addresses the scope of the rulemaking capabilities of the MINEFI (under Authorities Common to Credit Institutions and Investment Companies).

Article L. 621-1: Financial Markets Authority (2003). This article delineates the mission, composition, working rules, and powers of the AMF, and the guidelines

[2] The CCLRF replaced the Banking and Financial Regulation Committee (Comité de la Réglementation Bancaire et Financières) and the Regulatory Commission of the Insurance National Council (Commission de la Réglementation du Conseil National des Assurances).

for its relations with auditors and for means of redress.

Article L. 613-1: Banking Commission (1984, 2007). This article details the mission, composition, exercise of control, and disciplinary powers of the CB. It also addresses judicial reorganization and liquidation of credit institutions and investment firms and the implementation of the Deposit Guarantee Funds.

Article L. 612-1: Committee of Credit Institutions and Investment Firms (2001, 2003, 2007). This article covers the missions, composition, and working rules of the CECEI.

Article L. 614-1: Consultative Authorities (2000). This article deals with the Advisory Committee on Legislation and Financial Regulation and other consultative authorities.

Existing legislation for insurance comes from three different codes: (a) the *Insurance Code*, which applies to insurance entities organized in the form of commercial or cooperative corporations, (b) the *Mutual Insurance System Code*, which applies to certain entities providing health insurance organized as mutual corporations, and (c) the *Social Security Code*, which applies to certain providers of pension schemes.

Article 310: General Provisions and State Control (1981). This article describes general provisions and penalties associated with state-controlled insurance activities and information on the Insurance Supervisory Commission.

Article 413: Insurance Firms' Committee (2003). This article provides general information on the Insurance Firms' Committee, which licenses insurance firm activity.

Nonstatutory Elements

No nonstatutory elements have been noted.

Institutional Structure of the Regulators

The French regulatory structure is characterized as a functional system with some elements of a twin peaks approach.

Ministry of Economy, Finance and Industry (MINEFI)

The MINEFI has a role in the supervisory structure of the financial regulatory system. It is responsible for drafting new legislation and issuing regulations regarding banking operations, investment services, and insurance activities, in consultation with the CCLRF. The MINEFI is also responsible for approving the General Regulations of the AMF, which include, among other provisions, the rules of professional practice applicable to issuers and to takeover bids, the rules of good conduct and other professional obligations of investment service providers, the conditions under which investment service providers render their services, the conduct-of-business rules for custody and administration of financial instruments, and the general organizational and operational principles for settlement-delivery systems and for regulated markets and multilateral trading facilities. The Director General of the Treasury is a member of the governing boards of CB, the CECEI, and the CEA. The government also provides a commissioner to the boards of the ACAM and the AMF.

The MINEFI supervises the French Deposit Guarantee Funds (FGD). Upon a request from the CB, the FGD can release funds in the event of a bank failure. (See below.)

Deposit Guarantee Fund (FGD)

The FGD is a private institution funded by contributions of all credit institutions and investment firms to guarantee deposits up to €70,000, with no co-insurance. It also covers investment firms. Funds can be released only with the agreement of the CB (with the advice of the AMF). In certain circumstances, the FGD can be authorized to use a portion of its funds preventively, to provide financial support to a failing credit institution or investment firm. A similar guarantee scheme is in place for the insurance industry, linked to the ACAM.

Bank of France (BDF)

The BDF is the central bank of France and provides prudential supervision for credit institutions and investment firms. It issues currency and determines monetary policy within the parameters of its membership in the Eurozone and as a member of the European System of Central Banks. The BDF has a further supervisory role through its linkages with, and leadership in, the boards of other supervisory agencies. The Governor of the BDF is the Chairman of the CB and the CECEI. The Governor also sits on the boards of the CCLRF, the AMF, and the ACAM.

Banking Commission (CB)

The CB's mission is to oversee the banking and financial system to ensure safe and sound practices and financial stability. The CB is responsible for prudential supervision of credit institutions, investment service providers, and persons authorized to exercise custody or administration of financial instruments. The CB examines the credit institutions' operations and financial condition.

The CB is composed of the Governor of the BDF, who serves as Chairman; the Director of the Treasury; the Chairman of the ACAM; and the following four members or their deputies appointed by the Minister for Economy, Finance and Industry to a five-year term, renewable once: a Counselor of State proposed by the Vice-Chairman of the State Council; a counselor member of the Court of Cassation proposed by the Executive Chairman of the Court of Cassation, and two financial industry specialists.

The BDF provides human resources and other support to the General Secretariat of the CB to conduct inspections and ongoing supervision.

Committee of Credit Institutions and Investment Firms (CECEI)

The CECEI licenses credit institutions and investment services providers and shares information related to approved institutions and service providers with the AMF and other authorities within the EU.

The CECEI is chaired by the Governor of the BDF. The CECEI governance structure also includes the Director of the Treasury, the Chairman of the AMF, the Chairman of the Executive Board of the FGD, and eight members or their deputies, appointed by order of the Minister of Economy, Finance and Industry to three-year terms. The members of the CECEI report on an annual basis to the Minister and the advisory committee of the financial sector. The BDF provides human resources and other support to the CECEI.

Financial Markets Authority (AMF)

The AMF oversees the protection of public savings invested in financial instruments and all other investments offered to the public, the disclosure of financial information to investors, and the proper functioning of financial markets. In doing so, it establishes the organizational and operational principles for markets, sets conduct-of-business rules for the professionals under its supervision, and oversees the collective investment vehicles that are subject to its approval. The AMF also contributes to the regulations applicable to these markets at the European and international level. The AMF monitors securities transactions and collective investment products to ensure compliance with investor disclosure requirements.

The AMF has a governing body referred to as a "college," a disciplinary committee, and, when required, specialist committees and consultative committees. The college is composed of 16 members, each with a five-year term, with some exceptions.[3] The AMF also has a Sanctions Committee (Commission des Sanctions) responsible for imposing disciplinary actions. This Committee has 12 members, each of whom serves a five-year term.

The AMF has financial autonomy. Its budget is determined by the college on a proposal from the Secretary General of the AMF. It receives income from taxes paid by the institutions it supervises.

Insurance and Mutual Societies Supervisory Authority (ACAM)

The ACAM is an independent public agency and is the prudential supervisor of the insurance sector. It oversees insurance companies, firms underwriting reinsurance, mutual insurance companies, unions, and federations governed by the Social Security Code, complementary retirement institutions, and the organizations governed by Article L727-2 of the Rural Code, and it ensures that they comply with the law and contractual commitments that bind them with the insured and members. The ACAM, as the prudential supervisor, examines firms' financial status and monitors general business conditions in the sector.

The ACAM governing body is composed of nine members: (a) a Chairperson named by decree; (b) the Governor of the BDF; (c) a Counselor of State, nominated by the Vice-President of the State Council; (d) a Counselor Member of the Final Court of Appeals, nominated by the First President of the Final Court of Appeals; (e) a Counselor, Head of the State Audit Office, nominated by the First President of the State Audit Office; and (f) four members chosen for their industry expertise. The Chairperson, the Counselor of State, and the four members chosen for their expertise serve five-year terms.

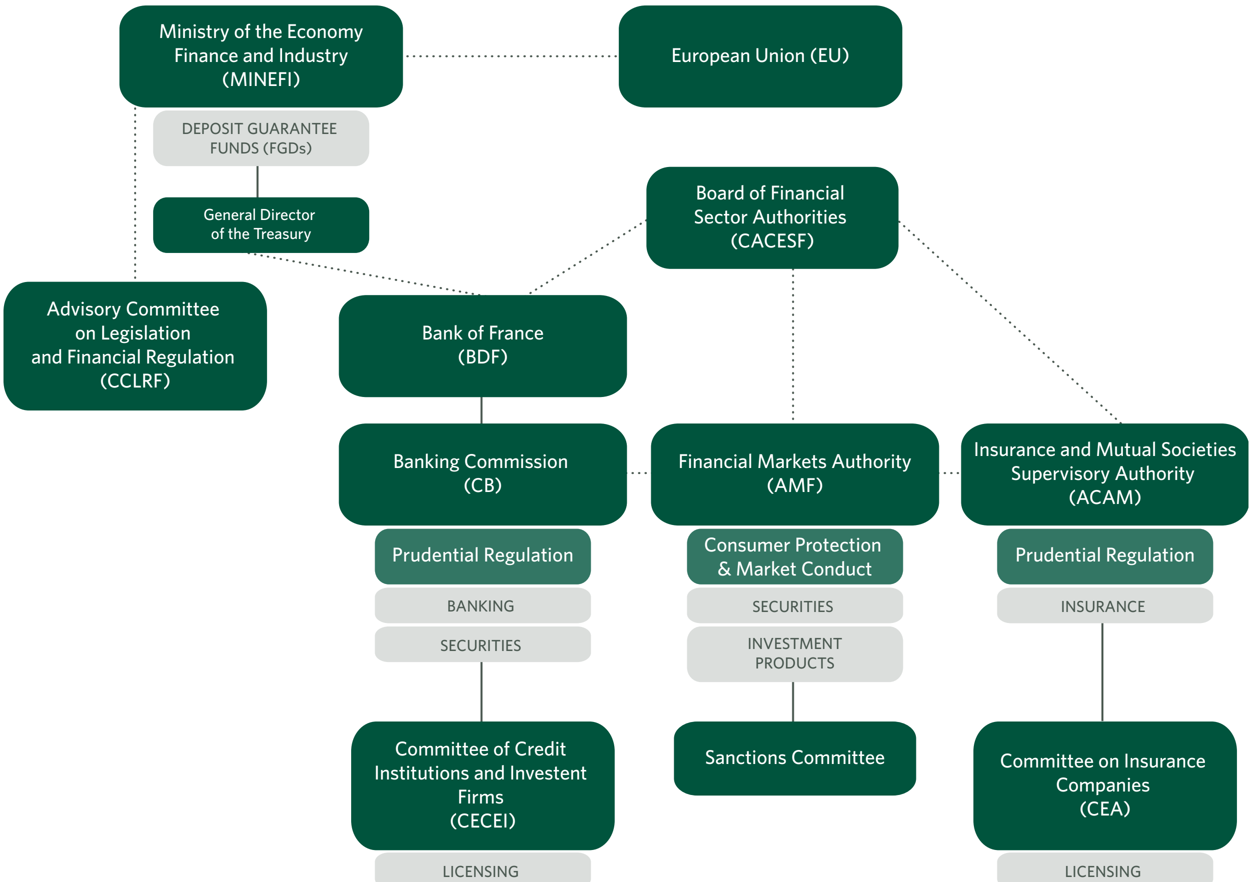
The ACAM has financial autonomy. It receives its income from the contributions paid by the insurance and mutual societies under its supervision.

The Committee of Insurance Companies (CEA)

The CEA licenses insurance firms, mutual insurance companies, provident institu-

[3] The AMF's governing board is composed of (a) a Chairman, appointed by presidential decree; (b) a Counsellor of State, appointed by the Vice-Chairman of the Council of State; (c) a Counsellor Member of the Court of Cassation, appointed by the President of the Court of Cassation; (d) a Chief Advisor to the Court of Auditors, appointed by the President of the Court of Auditors; (e) a representative of the BDF, appointed by the Governor (who serves until another is appointed); (f) the Chairman of the National Accountancy Council (who serves during the length of the chairmanship); (g) three members appointed, respectively, by the President of the Senate, the President of the National Assembly, and the President of the Economic and Social Council; (h) six members, appointed by the Minister of the Economy, Finance and Industry; and (i) a shareholder-employee representative, appointed by the Minister of Economy, Finance and Industry after consulting the representative trade unions.

FIGURE 5. The Financial Services System Regulatory Structure, France



Note: Dotted lines indicate a cooperative relationship.

tions, and firms underwriting reinsurance, but not underwriting direct insurance. In addition to its licensing role, the CEA can address competition matters and issues of concentration concerning, directly or indirectly, an insurance firm or a firm underwriting reinsurance but not underwriting direct insurance.

The CEA board is composed of a chairperson named by decree of the Minister of Economy, Finance and Industry; the Director of the Treasury; the chairperson of the supervisory committee for insurance companies, mutual insurance companies, and provident institutions; the Secretary-General of said committee; and eight other members named by decree to three-year terms.

Advisory Committee on Legislation and Financial Regulation (CCLRF)

The CCLRF is a legislative advisory committee that deals with broad policy issues related to credit institutions, investment firms, and insurance companies and their customers. The CCLRF may draft opinions or recommendations of a general nature. The Committee is composed of the Minister of Economy, Finance and Industry, who serves as Chairman, and 14 other members.[4] Except for the Governor of the BDF, the Chairman of the ACAM, the Director of Civil Affairs, a representative of the Ministry of Justice, and the other members of the Committee are appointed by decree of the Minister of Economy, Finance and Industry.

The CCLRF reports annually to the President of France and to the Parliament. CCLRF members are not paid employees. The BDF provides the CCLRF with a general secretariat and budgetary resources.

Figure 5 provides a graphic depiction of the relationship among the above-mentioned institutions.

Enforcement

The supervisory authorities have broad enforcement powers, covering all areas from licensing and individual authorization to disciplinary actions. The authorities can take administrative measures in the form of revocation of license, warning, injunction, reprimand, or a formal recommendation that may be published. In addition, the supervisory authorities are empowered to take disciplinary actions, which may include capital infusions, increased reporting, and/or requiring a change of management.

Institutions are subject to a range of sanctions for misconduct, including: warnings, reprimands, and a temporary or permanent prohibition on providing all or part of the services a firm previously provided. They can be fined, for instance, in the case of the AMF, by up to €1.5 million or 10 times the unlawful profits earned (five times when the professional in question is an individual, except in cases of market manipulation). These sanctions are subject to a normal appeals process.

When necessary in a time of crisis, Emergency Liquidity Assistance is at the discretion of the BDF, in coordination with the European System of Central Banks. However, when public funds are required and matters of solvency arise, the Minister of Economy, Finance and Industry must agree before the release of funds. In addition, the Ministry retains oversight of the FGD, whose action is triggered by the Banking Commission.

Framework for Domestic Coordination

The CACESF is a key part of the framework for domestic coordination. It is composed of the Governor of the BDF as Chairman of the CB, the Chairman of the ACAM, and the Chairman of AMF. The college was established to facilitate information exchanges among the principals of all supervisory authorities of financial groups engaged in lending, investment, and insurance activities, and to address any question of common interest relating to coordination and information exchange.

The CACESF meets at least three times a year. It may be consulted for an opinion by the Minister of Economy, Finance and

---

4 The membership of CCLRF includes (a) a representative of the French Assembly, appointed by its chairman; (b) a Senator, nominated by the Senate Chairman; (c) a Counsellor of State, nominated by the Vice-Chairman of the State Council; (d) the Governor of the BDF or his or her representative; (e) the Chairman of ACAM or his or her representative; (f) the Director of Civil Affairs and the Seal at the Ministry of Justice or his or her representative; (g) two representatives of credit institutions and investment firms; (h) two representatives of insurance companies; (i) a trade union representative that represents, at the national level, the staff of the companies in the banking and insurance sectors and the investment firms; (j) a representative of the customers of credit institutions, insurance companies, and investment firms; and (k) two people chosen for their expertise.

Industry; the Governor of the BDF, as Chairman of the CB; the Chairman of ACAM; and the Chairman of AMF on any question within its purview.

Additional coordination is facilitated through the series of cross-board memberships in the reformed structure, with principals or their representatives participating in the governing boards of associated agencies.

Further coordination in times of crisis or bank failures is aided through direct links between the BDF and CB, because the Governor of the BDF is Chairman of the CB. As such, the Governor has regular meetings with the General Secretary of the CB to review financial supervisory matters and, in particular, the ongoing health of systemically important banks. In times of stress, these meetings can escalate from weekly to daily to ensure coordination, and can also involve other agency heads, as needed. Discussions are private; there is no public disclosure. If a case involves a matter of public support, it is referred to the MINEFI. Supervisory decisions are to be taken by the board of the Banking Commission, which is chaired by the Governor, joined by a representative of the MINEFI.

When dealing with a possible bank failure, the Governor of the BDF takes the lead, supported by the General Secretary and staff of the CB. Discussions are private; there is no public disclosure. If a case involves a matter of solvency, the Governor of the BDF must secure the agreement of the MINEFI.

International Coordination

Please refer to the chart of international coordination activities and organizational participation on page 234. In addition, see the European Union profile for an explanation of coordinating activities within the EU.

Current Issues

The Minister of Economy, Finance and Industry has commissioned a study on how to further improve cooperation between the two prudential supervisory authorities, the CB and the ACAM. As part of this review, consideration will be given to a proposal to merge the two bodies. It is unclear how much support these further reform proposals have in the National Assembly. Moreover, some resistance to the change is evident from the insurance sector, parts of which remain supportive of the ACAM as a separate regulator. Given the high level of cooperation that already exists between the CB and the ACAM, it is unlikely that a merger would, in the short term, have a significant impact on the concrete prudential supervision of the French financial institutions.

ACRONYMS AND ABBREVIATIONS

ACAM	Insurance and Mutual Societies Supervisory Authority (Autorité de Contrôle des Assurances et des Mutuelles)
AMF	Financial Markets Authority (Autorité des Marchés Financiers)
BDF	Bank of France (Banque de France)
CACESF	Board of Financial Sector Authorities (College des Autorités de Contrôle des Entreprises du Sectuer Financier)
CB	Banking Commission (Commission Bancaire)
CCLRF	Advisory Committee on Legislation and Financial Regulation (Comité Consultatif de la Législation et de la Réglementation Financierès)
CDGF	Council on the Discipline of Financial Management (Conseil de Discipline de la Gestion Financière)
CEA	Committee on Insurance Companies (Comité des Entreprises d'Assurances)
CECEI	Committee of Credit Institutions and Investment Firms (Comité des Establissements de Crédit et des Enterprises d'Investissement)
CMF	Financial Markets Council (Conseil des Marchés Financiers)
COB	Market Operations Commission
COMOFI	Monetary and Financial Code (Code Monetaire et Financier)
€	Euros
EU	European Union
FGD	Deposit Guarantee Funds (Fonds de Garantie des Dépôts)
MINEFI	Ministry of Economy, Finance and Industry

ITALY

Market Description

The Italian financial system is composed of a variety of financial institutions, with banks playing, directly or indirectly, the dominant role. In 2007, there were 806 banks, comprising 249 commercial banks, 38 cooperative banks, 440 mutual banks, and 79 branches of foreign banks.[1] A wave of bank mergers occurred in the 1990s, and additional consolidation took place in 2007, significantly increasing market concentration. The top five institutions' (Unicredito, Intesa Sanpaolo, Monte dei Paschi, Banco Popolare, and UBI) share of total domestic banking assets rose from 45 percent in 2005 to 52 percent in 2007.

Non-bank financial companies play an important role in the financial markets, and during the past several years have increased in number, due mainly to securitization special-purpose vehicles, which make up more than half of all registered financial companies. Financial companies' share of the consumer credit market grew moderately, but banks continued to dominate the sector with 55 percent. The market share of independent intermediaries decreased from 21 percent to 15 percent. Foreign intermediaries maintained a presence, directly or indirectly controlling approximately 40 registered financial companies.

The Italian asset management industry is based on a vertical integration between distribution networks (banks and insurance companies) and asset management companies owned by banks that distribute their products. At the end of 2007, there were 107 registered investment firms.

The insurance sector includes some of the largest European insurance companies (for example, Generali SpA, Fondiaria-SAI). At the end of 2007, 172 companies were authorized to conduct insurance and reinsurance business in Italy, 163 of which were domestic firms.

Background

The Italian financial regulatory structure can be described as a combination of two approaches, because it is partly structured along functional lines (banks, insurance, securities) and partly along institutional lines. The structure is the result of the way the financial system was reshaped in the 1930s, in the aftermath of the Great Depression, and the reforms brought about in the 1980s and 1990s, driven by financial innovation and European integration. In the 1930s the government and the Central Bank rescued the major commercial banks from collapse. The main response took two forms. The first was a major shift from private to public ownership of major banks and industrial groups, achieved through the creation of a large, publicly owned entity, the Institute for Industrial Reconstruction (IRI), which acquired the equity holdings of the ailing banks and a controlling stake in the banks themselves. The second was passage of a new *Banking Law* (1937), which required a sharp separation between banking and industry.

The *Banking Law* (the Law) of 1936 established the Bank of Italy as a public institution functioning as a central bank, and prohibited from lending to non-banks. The Law also reformed credit and financial supervision, revamping the credit system through a separation between banking and industry and between short- and long-term credit (these provisions were repealed

---

[1] Banca d'Italia, Annual Report, Abridged Version, Ordinary Meeting of Shareholders 2006, 113th Financial Year, Rome, 31 May 2007, www.bancaditalia.it.

almost entirely in 1993). Supervision was concentrated in a newly created state body, the Inspectorate for the Defense of Savings and the Exercise of Credit, chaired by the Central Bank Governor and using resources and personnel of the Bank of Italy, but directed by a ministerial committee chaired by the Prime Minister.

Until the 1980s, the banking system was predominantly composed of publicly owned intermediaries and was highly fragmented. Institutions were classified as "ordinary" (commercial) banks or as special credit institutions. While all operated largely in the same way, ordinary banks had different legal status: commercial banks, saving banks (mainly established as public institutions controlled by local communities), cooperative banks, and mutual banks. Each bank had geographic restrictions on its activity. Competition was discouraged. The creation of new banks was forbidden and the opening of new branches was strictly limited and subject to authorization.

Changes began in the 1980s and accelerated in the 1990s. They were largely the result of the progressive creation of a single European market for banking and financial services. The implementation of the European Union's (EU) *First Banking Directive* (1977) removed the prohibition to create new banks, and the EU's *Second Banking Directive* (1988) removed most of the other substantial barriers to entry. At the end of the 1980s, impediments to foreign operations of banks were also removed, and foreign exchange controls, which had been in place in Italy in one form or another since 1934, were lifted.

In the 1980s and 1990s, both the industry and the regulatory structure of the Italian financial system made a decisive departure from the closed, static, uncompetitive, protected, and publicly owned configuration inherited from the 1930s. In 1990, three laws were passed. The first established a level playing field for banks, specified the shareholder-owned company as the general model for the banking business, prepared for the privatization of banks, and regulated credit groups. The second regulated securities intermediaries and stock markets. The third introduced antitrust principles and instruments.

Statutory Framework

The three main pillars of the present regulatory framework are: the *Consolidated Law on Banking* (CLB), the *Consolidated Law on Finance*, and the *Code of Private Insurance*.

The *Consolidated Law on Banking* (CLB) (1993). Under the CLB, the Bank of Italy issues the regulations governing the activity of banking and non-banking intermediaries and monitors their operations to preserve financial stability. The Bank of Italy exercises regulatory powers, issuing general rules concerning capital adequacy, limitation of risk in its various forms, permissible holdings, administrative and accounting procedures, and internal control mechanisms.

The *Consolidated Law on Finance* (1998), known as the Finance Code, regulates the financial services sector and the relationships among different authorities on a functional basis.

The *Code of Private Insurance* (2005) reformed the insurance sector and strengthened the role of the Insurance Industry Regulatory Authority (ISVAP) as the insurance sector supervisor and regulator. The *Code* introduced the principle that the primary purpose of supervision is the sound and prudent management of insurance and reinsurance entities.

In addition to these main pillars, other relevant legislation was introduced in the course of this decade, partly as a response to financial episodes affecting the Italian market and partly as a result of newly introduced European legislation.

The *Company Law* (2004), the law governing the organization of Italian companies, contains provisions on corporate governance of banks and banking groups. Antitrust powers were shifted from the Bank of Italy to the Antitrust Authority. The Law also strengthened the role of the securities supervisory agency, the Companies and Stock Exchange Commission (CONSOB), as the authority regulating companies, securities, and financial markets.

The *Law on the Protection of Saving and Financial Market Regulation* (2005) introduced rules to strengthen companies' internal controls and public controls for the protection of savings, to enhance the transparency of markets, to enhance the quality of financial information, and to foster cooperation among authorities. The law marginally modified the supervisory framework, strengthening the independence of the supervisory authorities, reinforcing the division of regulatory and control functions, and emphasizing cooperation among the authorities.

The *Competition and Fair Trading Act* (1990) established the Antitrust Authority (the Authority). The Authority is an independent public agency. Parliament introduced national antitrust legislation in response to the requirements of Article 41 of the Constitution, which protects and guarantees the right of free enterprise, to bring Italy's legislation into line with European Community law.

The *Italian Regulation on Pension Funds* (2005) regulates the pension funds system.

Nonstatutory Elements

No nonstatutory elements have been noted.

Institutional Framework of the Regulators

Italian financial regulation is organized as a mixed functional and institutional system, involving the following institutions.

Ministry of the Economy and Finance

The Ministry of Economy and Finance coordinates with the supervisory agencies. Although the Ministry and the Treasury are not primary supervisors of financial institutions, they retain overall responsibility for providing general policy guidance. In addition, the Minister of Economy and Finance is Chair of the Interministerial Committee for Credit and Savings (CICR).[2] The Ministry and Treasury also have a major role in the event of financial crisis.

The coordination among the Ministry, the Bank of Italy, CONSOB, and ISVAP is aimed at the prevention, management, and resolution of financial crises. At the level of principals, the Ministry sits on the Financial Stability Committee (FSC), which is tasked with dealing with financial crises and institutional failures with potential cross-border implications. In the rare cases when action might be deemed necessary either via special administration or compulsory administrative liquidation,
the action is initiated by a decree of the

---

[2] The CICR is staffed by the Bank of Italy and chaired by the Minister for Economy and Finance. It provides a link betweeen the two institutions, primarily for matters concerning supervision, and handles relations with customers of banks and financial intermediaries regarding matters of a general nature.

Ministry, based on a proposal from the Bank of Italy or CONSOB. A similar procedure is followed for insurance failures: on advice from ISVAP, the Ministry has the power to issue a decree placing the entity under administrative control.

Bank of Italy

The Bank of Italy is the central bank of Italy and is independent. As the supervisory authority, the Bank of Italy seeks to ensure the sound and prudent management of intermediaries and the overall stability and efficiency of the financial system.

The governance of the Bank of Italy consists of the Directorate (for policy-making) and the Board of Directors (for administration). The Board is composed of the Governor and 13 directors, and is responsible for the general administration, management supervision, and internal control of the Bank. The Directorate consists of the Governor, a Director General, and three Deputy Directors General. The Governor is appointed by the government and approved by the President of the Republic. He or she serves a six-year term, which may be renewed once. The Deputy Directors General serve six-year terms, renewable once. The Bank reports annually to Parliament on its activities. The Bank of Italy's funding comes from management of the assets it owns as a central bank.

Deposit Insurance Schemes

The Interbank Deposit Protection Fund, established in 1987, is supervised by the Bank of Italy. The Fund, (which became operative in January 1997), guarantees the deposits of member banks, which pay contributions to the Fund and make regular payment to defray operating costs. The scheme has ex post funding with a maximum insured amount of €103,291. There is no co-insurance.

Cooperative banks are members of a similar but separate fund, the Deposit Guarantee System of Mutual Banks, which has the same structure. This fund also has ex post funding, with a maximum insured amount of €103,291. There is no co-insurance. The Bank of Italy has full powers to supervise and coordinate the activities of both deposit protection funds.

Companies and Stock Exchange Commission (CONSOB)

CONSOB is the government agency responsible for the supervision of the Italian securities market and investment services. It was established in 1974, to perform supervisory functions over stock exchanges that were previously performed by the Ministry. It became an independent entity in 1985, when it was granted broad organizational and operational autonomy. CONSOB's responsibilities include ensuring transparency and responsible market conduct by securities market participants and disclosure of complete and accurate information to shareholders, including prospectuses related to securities offerings. CONSOB conducts investigations into potential violations of insider dealing and market manipulation.

CONSOB's governing body is a Commission of five members, including the Chairman. The Chairman and the members are appointed by the government and approved by the President of the Republic for a seven-year term and may be reappointed once. Funding for CONSOB is provided through a state budget allocation supplemented by fees paid by licensed entities.

Insurance Industry Regulatory Authority (ISVAP)

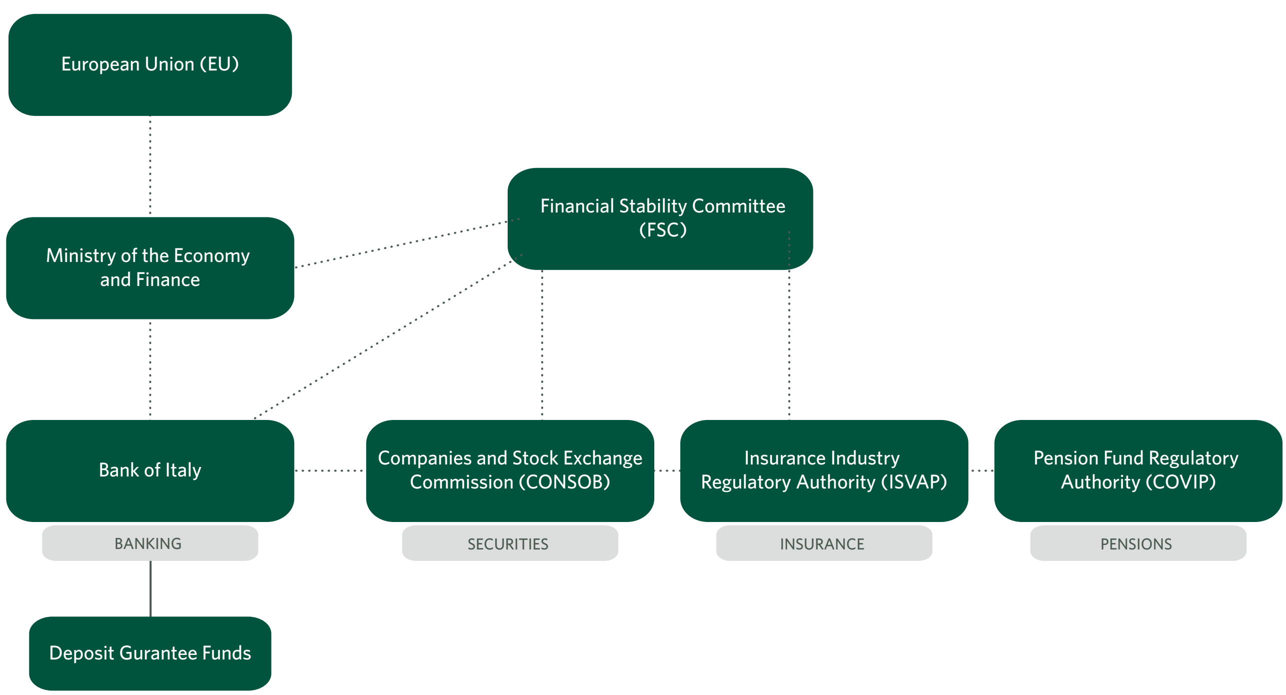
ISVAP is the independent supervisory authority for the insurance industry. Its objective is to ensure the sound and prudent management of insurance and reinsurance entities by regulating and monitoring their activities. ISVAP can adopt any regulation required for the sound and prudent management of companies and the transparency and fairness in the behavior of supervised entities.

The President of ISVAP is appointed by the President of the Republic to a five-year term, renewable once. The governing body of ISVAP is a Board of Directors, which consists of six members, in addition to the President. The board members are appointed to four-year terms and may be reappointed once. ISVAP's President acts as Director General of the organization. Its expenditures are covered by fees generated from the supervision of the supervised entities, along with interest earned on bank deposits and income from financial management.

Pension Fund Regulatory Authority (COVIP)

COVIP is responsible for supervising pension funds. Its main responsibilities are to authorize and supervise pension funds and ensure transparency. The agency is governed by four members and a Chairman, appointed by the Prime Minister. The Chairman and the four members serve four-year terms, renewable once.

FIGURE 6. **The Financial Services System Regulatory Structure, Italy**



Note: Dotted lines indicate a cooperative relationship.

Antitrust Authority (Authority)

The Authority is responsible for enforcing legislative provisions against anticompetitive practices: agreements that impede competition, abuses of dominant position, and mergers and acquisitions that eliminate or restrict competition. The Authority is a collegiate body composed of a Chairman and four Members appointed jointly by the Presidents of the Senate and the Chamber of Deputies. The Chairman and the four members remain in office for a seven-year, nonrenewable term. The Authority is funded by the government through an annual budgetary allocation.

Figure 6 provides a graphic depiction of the relationship among the above-mentioned institutions.

Enforcement

The Bank of Italy has broad powers of enforcement. These include the power to take disciplinary action, impose administrative sanctions and, where necessary, propose to the Minister of the Economy and Finance the initiation of special crisis procedures of supervised entities under special administration and compulsory administrative liquidation. Moreover, the Bank of Italy, acting as supervisory authority, is responsible for the direction and coordination of those special crisis procedures for all banking and financial intermediaries.

CONSOB has broad enforcement powers similar to the Bank of Italy. It exchanges information with the judicial authorities to identify violations of rules and regulations on market abuse, insider trading, and market manipulation. It can prohibit intermediaries from engaging in new transactions, suspend the Board of Directors, impose fines, and place intermediaries in special administration or liquidation.

ISVAP has the same powers of enforcement as the Bank of Italy.

Framework for Domestic Coordination

The Bank of Italy, CONSOB, and ISVAP have various mechanisms in place to facilitate cooperation and coordination. Procedures for cooperation among these supervisory authorities have been established by the *Consolidated Law on Banking*, and the *Consolidated Law on Finance* and, more recently, by a Memorandum of Understanding (MoU). The three agencies cooperate with the judicial authorities by providing information requested and reporting significant violations of law identified in the performance of their activities.

In 2007, pursuant to the new European Union Markets in Financial Instruments Directive (MiFID), the Bank of Italy and CONSOB signed an MoU regarding each other's supervisory responsibilities, tasks, and the exchange of information.

In 2008, the Ministry of Economy and Finance, the Bank of Italy, CONSOB, and ISVAP signed an MoU for the prevention, management, and resolution of financial crises. The agencies established a Financial Stability Committee (FSC), whose main task is to strengthen information exchange for the coordination of the decision-making process aimed at preventing and managing systemic financial crises with potential cross-border implications. Each agency has a crisis management unit designed to support the work of the FSC, when required. The FSC is based on a voluntary agreement; it is not established by law and has yet to be tested by a financial crisis, but it was created in line with an approach and a model agreed to at the EU level.

Italian law provides for two main crisis management procedures for financial intermediaries: special administration and compulsory administrative liquidation. In both cases, the procedure is initiated by a decree from the Ministry of Economy and Finance, acting on a proposal from the Bank of Italy or CONSOB. In case of a crisis in the insurance industry, the Minister of Economy and Finance, upon ISVAP's proposal, may establish by decree that an entity be dissolved when there are serious irregularities in administration or serious violations of rules of law, administrative provisions, or articles of association regulating the undertaking's activity; or when serious financial loss is foreseen.

Special administration involves the appointment of one or more special administrators, who replace the troubled bank's management and take over the running of the company, with all the functions and powers attributed to its former directors. Its purpose is to ascertain the real situation of the bank, eliminate the irregularities, and foster solutions in the interest of depositors. Therefore, it is preventive in nature and may be adopted at an early stage of a bank crisis or where the conditions needed to ensure correct performance of banking are lacking. Compulsory administrative liquidation is ordered when a crisis is irreversible. As happens in bankruptcy proceedings for commercial businesses, with the liquidation order, the bank ceases to do business and its assets and liabilities are determined according to the bankruptcy rules. The receivers may assign all or part of the bank's assets and liabilities to another intermediary, with a view to limiting the repercussions of the failure.

International Considerations

Please refer to the chart of international coordination activities and organizational participation on page 234. In addition, see the European Union profile for an explanation of coordinating activities within the EU.

Current Issues

The national debate over the efficacy of the current mixed institutional system continues. In 2007 the Prodi Government submitted to Parliament a regulatory reform aimed at fully implementing the twin peaks approach. The proposal vested all financial stability and prudential powers within the Bank of Italy, and placed transparency and market conduct responsibilities under the authority of CONSOB; ISVAP and COVIP would have been suppressed. The new legislation failed to pass because of the premature dissolution of Parliament in early 2008. However, both center-left and center-right party coalitions had expressed support for the reform. New legislation may be proposed by the current government.

ACRONYMS AND ABBREVIATIONS

CICR	Interministerial Committee for Credit and Savings (Comitato Interministeriale per il Credito ed il Risparmio)
CLB	Consolidated Law on Banking (Testo unico bancario)
CONSOB	Companies and Stock Exchange Commission (Commissione Nazionale per le Società e la Borsa)
COVIP	Pension Fund Regulatory Authority (Commissione di Vigilanza sui Fondi Pensione)
EU	European Union
FSC	Financial Stability Committee (Comitato per la Stabilità Finanziaria)
IMI	Italian Industrial Finance Institute (Istituto Mobiliare Italiano)
IRI	Institute for Industrial Reconstruction (Istituto per la Ricostruzione Industriale)
ISVAP	Insurance Industry Regulatory Authority (Istituto per la Vigilanza delle Assicurazioni Private)
MiFID	Markets in Financial Instruments Directive of the European Union
MoU	Memorandum of Understanding

SPAIN

Market Description

The Spanish financial system comprises three groups of institutions that cover distinct but increasingly integrated markets of unequal size: banking, insurance and pension funds, and securities markets entities. The dominant sector is banking, with approximately 70 percent of total assets; followed by investment funds and securities, with 20 percent of assets; and by insurance and pension funds, with 10 percent of total financial assets.[1] Total assets within the banking system are subdivided among banks, with 43 percent of total activity; savings banks, with 40 percent; credit cooperatives, with 4 percent; and specialized credit institutions, foreign subsidiaries, and branches, with 13 percent of the activity. The Spanish banking system encompasses a wide range of credit institutions (365), whose business model is focused on retail banking and traditional financial intermediation.

The second-largest segment of the financial services market is the securities market, which includes securities firms (about 120), mutual funds (more than 6,000 including their management entities), and money market funds. During 1991–2006, the total assets administered by the industry (including Collective Investment Institutions, pension funds, and venture capital entities) increased from 13 percent of gross domestic product to 44 percent.

Insurance companies, the third sector, are backed by a Public Insurance Consortium, which is part of the Ministry of Economy and Finance (MEH). The pension fund market, a relatively new market, began operating in 1989, and complements the compulsory "pay-as-you-go" pension fund with a private system.

Background

Spain's current financial regulatory system is evolving from a functional model to a modified twin peaks system. There are three prudential supervisors for banks, investment firms, and insurance companies: the Bank of Spain (BDE), which is also the Spanish central bank; the National Securities and Exchange Commission (CNMV), which is responsible for the supervision of financial markets' conduct-of-business and for investor protection, for the prudential supervision of investment firms, mutual funds, and risk capital management entities, and for all Spanish securities trading and post-trading infrastructures; and the General Directorate of Insurance and Pension Funds (DGSFP). While the BDE and CNMV are independent agencies, the DGSFP falls under the auspices of the MEH.

Over the last 20 years, the development of an appropriate regulatory and supervisory framework has paved the way for the modernization of the Spanish financial system. The Spanish economic and banking crisis in the late 1970s and early 1980s resulted in calls for a reform of the financial system, supported by a parallel liberalization and re-regulation of the regulatory and supervisory framework. It has evolved from an interventionist and protectionist approach to a more flexible one. It focuses on preventive rather than corrective measures, in compliance with European Union (EU) harmonized legislation and international standards. Spain joined the EU in 1986, the European Monetary System in 1989, and the Economic and Monetary Union in 1999.

Among the measures taken, the BDE was vested with the powers, tools, and

[1] International Monetary Fund, Financial Sector Assessment Process for Spain.

resources to act as an independent supervisor and central bank, and as a member of the European System of Central Banks. Spain's financial market became increasingly integrated with European and global markets as restrictions to capital flows were progressively eliminated, new monetary and financial instruments developed as a result of technological and communication innovations, and as business was internationalized.

Statutory Framework

Law 13/1994 of Autonomy of the Banco de España established BDE's objectives, functions, and powers as a central bank within the Eurosystem, and as a banking supervisor and regulator.

Law 26/1988 of Discipline and Intervention of Credit Institutions established the supervisory framework of the BDE, in particular, its enforcement and sanction capacity.

The basic law for securities and the CNMV is *Law 24/1988 of Securities Markets* (*Ley 24/1988 del Mercado de Valores*), which created the agency and granted regulatory and supervisory powers. Another key law is *Law 35/2003 of Collective Investment Institutions* (*Ley de Instituciones de Inversión Colectiva*).

The key laws for insurance and the DGSFP are *Law 50/1980 of Private Insurance Contract*; the *Insurance Supervising Law* (*Texto Refundido de la Ley de Ordenación y Supervisión de los Seguros Privados*, RDL 6/2004); the *Insurance Intermediation Activity Law* (*Ley de Mediación de Seguros y Reaseguros Privados*, 26/2006); and the *Pension Funds Law* (*Texto Refundido de la Ley de Regulación de Planes y Fondos de Pensiones*, RDL1/2002).

Nonstatutory Elements

No nonstatutory elements have been noted.

Institutional Structure of the Regulators

Spain's current financial regulatory system can be described as evolving toward a modified twin peaks system. As explained, there are three prudential supervisors for banks (BDE), investment firms (CNMV), and insurance companies (DGSFP). In addition, the Regional Governments (Comunidades Autónomas) have limited regulatory and supervisory powers over certain financial intermediaries in their respective jurisdiction. In particular, they have limited powers over savings banks and credit cooperatives, which do not include solvency or financial stability issues but pertain to certain aspects of corporate governance, consumer protection, transparency, and social contributions. In these areas, there is smooth cooperation between the BDE and Regional Governments. The Regional Governments also have certain supervisory authority over regional markets and their trading and post-trading infrastructures.

Ministry of Economy and Finance (MEH)

The MEH has wide regulatory powers over the financial system within the framework of the rule of law. The development of laws and MEH's regulations on technical implementation rules can be delegated to the BDE and the CNMV, which, according to their lawful duties, have the technical knowledge and expertise to directly address the more complex sectoral issues. The involvement of the MEH in the financial regulatory process is meant to ensure consistency among the three financial sectors (banking, securities, insurance), the supervision of which is assigned to three different agencies.

The MEH grants credit institution and investment firm licenses, based on the reports of the BDE and CNMV. It is also responsible for imposing the most serious sanctions on institutions, when such action is proposed by their prudential supervisor. Decisions taken by the BDE and the CNMV in relation to institutions can be appealed before the MEH.

General Directorate of Insurance and Pension Funds (DGSFP)

The DGSFP, which is part of the MEH, is responsible for supervision of private insurance and reinsurance, insurance intermediation, capitalization, and pension funds. The DGSFP does not have regulatory powers; however, the MEH takes into account its proposals before issuing insurance regulations. The DGSFP receives its budget as part of the government's budget.

Bank of Spain (BDE)

The BDE is the prudential supervisor and regulator of banks (credit institutions) in Spain, and is also the Spanish central bank. It is responsible for the supervision of the solvency and performance of credit institutions, and for their compliance with sectoral regulations. It is an independent authority, with operational and budgetary autonomy. Its financial resources come from its operational income and not from fees charged to supervised institutions.

The BDE has the authority to formulate detailed rules for credit institutions, called "circulars." For example, it is within the BDE's jurisdiction as banking supervisor to issue circulars on credit institution solvency and accounting rules. The BDE conducts ongoing supervision of Spanish credit institutions, based on close monitoring, on both an individual and a consolidated basis, underpinned by frequent on-site visits by in-house bank examiners, and detailed regular and ad hoc supervisory reporting, complemented by a comprehensive Central Credit Risk Register. In addition, all Spanish credit institutions are subject to an external statutory audit of their annual financial accounts, which is complemented by a supplementary ad hoc report to the BDE.

The BDE follows a risk-focused supervisory model in order to gain and maintain updated, in-depth knowledge of each credit institution's risk profile. This model allows for the BDE's efficient systematization of working methods and for the adoption of timely preventive measures, while also providing incentives for risk management and internal governance improvements in supervised entities.

BDE is led by a Governor and Deputy Governor, the first proposed by the President of the Government and appointed by the King, and the second proposed by the Governor and appointed by the Government. Both are appointed for six-year, nonrenewable terms. BDE's governing board includes the Governor and Deputy Governor, and six other members proposed by the MEH (board members serve for six years, renewable for another six), the Director General of the Treasury, and the Vice-President of the CNMV. The managing directors of the BDE, the BDE's Secretary General, and a representative of the BDE's employees have nonvoting rights on the board. Reporting to the governing board is an Executive Commission, composed of the Governor and Deputy Governor, two of the six board members, the Managing Directors of the BDE, and the Secretary General (nonvoting).

Spanish Financial Intelligence Unit (SEPBLAC)

The SEPBLAC has the legal authority and responsibility for supervising and enforcing compliance with anti-money laundering and terrorist financing (AML) rules. Although the BDE is not empowered with supervisory responsibilities regarding AML, the BDE and the SEPBLAC have signed a Memorandum of Understanding (MoU) for cooperation and information sharing. BDE assists SEPBLAC by providing it with human and financial resources.

National Securities and Exchange Commission (CNMV)

The securities markets and investment firms are supervised by the CNMV, which oversees Spanish stock markets and the activities of all the participants in those markets. The CNMV's statutory regulatory competences are delegated by the MEH. The CNMV's financial resources come from fees paid by the institutions subject to supervision. Distribution of excess funds to the Treasury can occur. The agency's budget must be approved annually by the Parliament as part of the normal governmental budgetary process.

The objective of the CNMV is to ensure the transparency of the Spanish markets and to protect investors. The CNMV focuses on promoting the improvement of the quality of information disclosed to investors and enforcing rules of conduct, but it also has prudential authority over a number of securities entities. The CNMV devotes considerable effort to detecting and pursuing illegal activities by unregistered intermediaries. It uses primarily off-site supervision, requiring extensive regular and ad hoc information from all publicly quoted companies, but also on-site supervision, focusing on areas of higher potential risk. Like the BDE, the CNMV has a risk-focused supervisory model.

The CNMV is led by a President and Vice-President, both appointed by the Government for four years, renewable once. Other members of the Governing Council include three members appointed by the Ministry of Finance, each appointed for four years, renewable once; the Director General of the Treasury; and the Deputy Governor of the BDE. Reporting to the CNMV is an Executive Commission composed of the members of the Board, excluding the Director General of the Treasury and the Deputy Governor of the BDE. The CNMV has a Consultative Committee, chaired by the CNMV Vice-President, which consists of 17 members representing the different members of the securities markets, issuers, and investors in Spain.

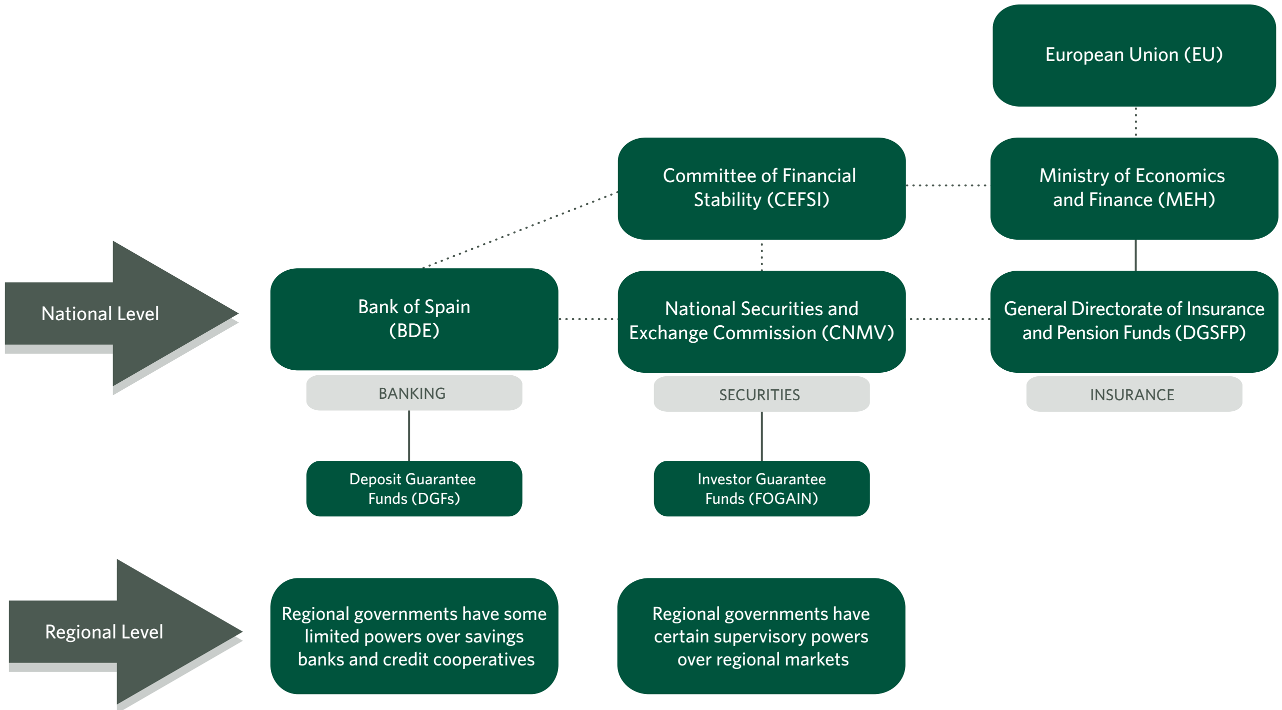
The Investor Guarantee Fund (FOGAIN) guarantees money or securities entrusted to an investment firm, up to a maximum of €20,000 per investor, when the firm is unable to return them to its client for reasons related to its own financial position (not market risk). When the money or securities are entrusted to credit institutions, this same guarantee is provided by the three Deposit Guarantee Funds for banks, cooperatives, and savings banks. All deposit guarantee funds have ex ante funding, and a maximum payout limit of €20,000 per investor. In exceptional circumstances, they may receive additional contributions from the BDE.

Figure 7 provides a graphic depiction of the relationship among the above-mentioned institutions.

Enforcement

The BDE and CNMV have enforcement powers over Spanish credit institutions and investment firms. The BDE has a wide range of preemptive tools to address an entity facing major difficulties, including the issuance of requirements or binding instructions, commonly accompanied by

FIGURE 7. **The Financial Services System Regulatory Structure, Spain**



Note: Dotted lines indicate a cooperative relationship.

action plans encompassing limitation of activities, disinvestment in specific assets, and measures to increase own funds.

The BDE and the CNMV can use sanctions against supervised entities. The BDE has the power to levy varying degrees of sanctions on credit institutions, their management, and relevant shareholders. The decision over the imposition of sanctions for very severe infringements rests with the MEH, upon the advice of the BDE, except for the revocation of a banking license, which is the responsibility of the Council of Ministers. The CNMV has an almost identical legal disciplinary framework.

Framework for Domestic Coordination

The three supervisors—BDE, CNMV, and DGSFP—are legally obliged to cooperate with each other for the effective performance of their supervisory duties. For this purpose, they have signed bilateral MoUs, including the sharing of confidential supervisory information. Coordination among regulators is further supported via cross-membership of the boards of the BDE and CNMV.

In 2006, the three financial authorities, together with the MEH, endorsed a multilateral MoU for financial stability and the prevention and management of systemic crises. As a result, the Committee for Financial Stability (CESFI) was created to promote the exchange of information related to financial stability and the cooperation among financial authorities during both normal times and when financially stressed conditions risk causing systemic effects. The CESFI is an informal committee for the coordination of systemic crises management and resolution. It is chaired by the Secretary of State for Economy and includes the Deputy Governor of the BDE, the Vice-President of the CNMV, the Director General of Insurance, and the Director General of the Treasury. This committee follows the recommendation of the multilateral MoU for cooperation in crisis situations, signed in 2005 and renewed in June 2008, with the rest of the financial supervisory authorities, central banks, and finance ministries of EU countries.

The responsibilities of the different authorities during financial crises are explicitly set out in Spanish laws and regulations. The BDE, acting both as the central bank and as the banking supervisor, is the authority in charge of managing banking crises. As a central bank, it plays the role of lender of last resort, within the framework of the Eurosystem. In extreme circumstances, the BDE may take the decision of intervening in a credit institution, replacing its management, or involving the corresponding Spanish Deposit Guarantee Fund (DGF).[2] The DGFs in Spain have a twofold function, which constitutes a distinctive feature compared with other European guarantee schemes: they not only act as guarantee schemes (maximum €20,000 per depositor), but they can also take part in banking crises management (direct financial assistance, capital restructuring, and measures aimed at favoring a merger or acquisition by a sound institution), within the framework of restructuring plans approved by the BDE. The CNMV also has crisis management powers over the entities under its responsibility, and there is also, as previously noted, an Investor Guarantee Fund.

International Coordination

The BDE cooperates with foreign financial authorities in accordance with the principles of the Basel Committee and the European directives. The BDE has endorsed bilateral MoUs with banking supervisors of EU and non-EU countries, where there are branches or subsidiaries of some importance on either side. In addition, the BDE has endorsed multilateral MoUs within the EU with other central banks, financial supervisors, and ministries of economy.

Finally, according to the 2008 MoU among EU financial supervisory authorities, central banks, and finance ministries, Cross-Border Stability Groups are foreseen to be established for the management of cross-border financial crises within the EU. The CNMV also signed the 2008 EU MoU. The CNMV cooperates with the Ibero-American Institute of Stock Markets to foster progress and modernization of Latin America's securities markets through training and cooperation programs.

Please refer to the chart of international coordination activities and organizational participation on page 234.

Current Issues

The current model has demonstrated its efficacy over the years, supported by the fact that large financial groups in Spain are dominated by banks, as opposed to other countries where financial conglomerates play a major role. In recent years, there has been a recurrent internal policy debate about a potential change in the current model of sectoral financial supervision, with the prevailing alternative being the twin peaks model, which would consist

[2] There are three DGFs—for banks, saving banks, and credit cooperatives.

of the BDE's integrating the prudential supervision of banking, securities, and insurance, while another authority would be in charge of the supervision of financial markets and investors and financial customer protection. The MEH has publicly announced its intention to propose this institutional change to the Government.

ACRONYMS AND ABBREVIATIONS

AML	Anti-money laundering
BDE	Bank of Spain (Banco de España)
CESFI	Committee for Financial Stability (Comité de Estabilidad Financiera)
CNMV	National Securities and Exchange Commission (Comisión Nacional del Mercado de Valores)
DGF	Deposit Guarantee Fund
DGSFP	General Directorate of Insurance and Pension Funds (Dirección General de Seguros y Fondos de Pensiones)
EU	European Union
FOGAIN	Investor Guarantee Fund (Fondo de Garantía de Inversores)
MEH	Ministry of Economy and Finance (Ministerio de Economía y Hacienda)
MoU	Memorandum of Understanding
SEPBLAC	Spanish Financial Intelligence Unit (Servicio Ejecutivo de la Comisión de Prevención del Blanqueo de Capitales e Infracciones Monetarias)

THE INTEGRATED APPROACH

The integrated approach is one in which a single universal regulator conducts both safety and soundness oversight and conduct-of-business regulation for all sectors of financial services business.

Canada · Germany · Japan · Qatar · Singapore · Switzerland · The United Kingdom

CANADA

Market Description

In 2007, the Canadian banking sector, representing approximately $2.5 trillion[1] in assets,[2] comprised 20 domestic banks, 24 foreign bank subsidiaries, and 29 foreign bank branches. The Canadian banking industry contributes approximately 3 percent of total gross domestic product directly, or approximately $33 billion annually. Domestically, it employs some 250,000 people, about 1.5 percent of total employment. Within this sector, six Canadian banks dominate—the Royal Bank of Canada, the Canadian Imperial Bank of Commerce, the TD Bank Financial Group, The Bank of Nova Scotia, The Bank of Montreal, and the National Bank of Canada. At the end of fiscal 2007, these six banks combined represented $2.25 trillion in assets.

The mutual fund sector, with approximately $700 billion in assets in 2007, consists of the manufacturers of mutual funds and the distributors, with a number of mutual fund companies involved in both segments of the business, notably those owned by the banks and the credit unions (*caisses populaires*).

The Canadian securities sector is made up of integrated, institutional, and retail firms. The number of firms participating in the Canadian securities industry has risen significantly over the years. Although there are approximately 207 securities firms operating in Canada, the six largest integrated securities firms, which are owned by the big six domestic banks, continue to account for the largest share of total industry revenues—73 percent. Retail firms accounted for 15 percent of revenues while institutional firms accounted for 12 percent.

Canada's insurance sector includes 196 insurers with approximately $413 billion in assets under administration.[3]

Background

The current Canadian financial regulatory structure, which developed in response to bank failures in the 1980s, can be described as an integrated and functional hybrid, because it has characteristics of both integrated and functional systems.

The legislative and regulatory framework for banks is entirely federal. The federal government, through the Department of Finance, is responsible for the legislative framework, the Office of the Superintendent of Financial Institutions (OSFI) is the prudential supervisor, the Canada Deposit Insurance Corporation (CDIC) is the deposit insurer, the Bank of Canada is the lender of last resort, and the Financial Consumer Agency of Canada (FCAC) is responsible for adherence to consumer protection provisions in the Bank Act. The federal Competition Bureau, an independent agency, plays a major role in determining whether mergers among financial institutions can proceed. The OSFI and the Minister of Finance also have a role. The federal Financial Transactions Reports Analysis Centre of Canada is responsible for anti-money laundering and anti-terrorist financing, which, in the case of federal financial institutions, it has delegated to OSFI.

---

1 All dollar amounts are in Canadian dollars.

2 Trust and loan companies offer similar services to banks but administer estates, trusts, pension plans, and agency contracts. (While banks are not permitted to undertake these activities directly, the largest trust companies are subsidiaries of the major banks.)

3 Assets under administration usually represent assets beneficially owned by clients but administered by a company.

The Bank of Canada is the nation's central bank. In the early 1930s, a gathering depression and mounting criticism of the country's existing financial structure coincided with a concern over the lack of a direct means in Canada for settling international accounts. In 1933, a royal commission was set up to study the organization and working of the entire banking and monetary system and to consider the arguments for and against a central banking institution. The arguments "for" won, and in 1934 the Bank of Canada was founded as a privately owned corporation. In 1938, it became a Crown corporation belonging to the federal government.

From 1980 through 1986, 22 deposit-taking institutions, most of which were trust companies, failed in Canada, many as a result of aggressive growth strategies. The Office of the Superintendent of Financial Institutions (OSFI) was formed in 1987 as a result of these failures. OSFI is responsible for supervising the operations of banks and federally regulated financial institutions, including insurance companies and private pension plans. Prior to the establishment of OSFI, a Department of Insurance, an Office of the Inspector General of Banks, and the Canada Deposit Insurance Corporation (CDIC), together were responsible for overseeing the insurance and banking sectors of the industry.

OSFI, established in 1987, was created through the merger of the Department of Insurance (DOI) and the Office of the Inspector General of Banks (OIGB). The DOI (formerly called the Office of the Superintendent of Insurance) was established at the beginning of the 20th century in response to problems experienced in the industry. The role of the DOI was to oversee federally licensed life insurance and property and casualty insurance companies, trust and loan companies, and pension plans, and to provide actuarial services to the government. The OIGB was established in the mid-1920s as a result of the failure of the Home Bank, with the mandate to regulate Canada's chartered banks. At that time, the notion of a government inspection system for banks was not widely embraced—there were concerns about cost, efficiency, and duplication of work being performed by internal and external auditors. In response, the new regulatory system was patterned on the one in use in the United Kingdom, which did not include on-site examinations and placed a great deal of reliance on self-regulation.

The 1980 Bank Act allowed banks to have subsidiaries in different sectors such as venture capital and mortgage loans, which led to the creation or purchase of mortgage loan companies by the banks. In 1987, Canadian banks were permitted to invest in corporate securities and to distribute government bonds. All major banks made substantial investments in the securities business, and purchased control of most of the existing large investment dealers. In 1992, banks were given the right to enter the trust business through the establishment or acquisition of trust companies.

The regulation of the Canadian securities industry is carried out by the provinces and territories, each having its own securities regulator. Following the lead of a number of states in the United States almost a century ago to enact their own securities law, that is, the Blue-Sky Law, Canadian provinces began passing their own securities legislation shortly thereafter. The 13 provincial and territorial regulators collaborate through the Canadian Securities Administrators (CSA), whose goal is to develop a national system of simplified and harmonized securities regulation, policy, and practices while retaining regional flexibility.

In the past, the Bank Act prohibited Canadian banks from selling most types of insurance either directly or indirectly through subsidiaries; banks were restricted to selling a limited selection of insurance products viewed as incidental to the business of banking. Legislative reforms in 1987 and 1992 increased the potential for competition among financial institutions by enabling federal financial institutions to develop into financial conglomerates. The 1992 reforms extended the ability to own insurance subsidiaries. The issue of banks retailing insurance products in their branches emerged as a dominant subject of early debate during consultations for the 1997 review of federal financial institutions legislation. Current federal legislation allows limited retailing of insurance by banks but prohibits the complete integration of banking and insurance in Canada. The federal and provincial governments share regulation of the life- and health-insurance sector, with the main federal regulator being OSFI.

Statutory Framework

The *Bank Act* (1871) regulates Canada's banks. The Act divides banks into two groups—Schedule I and Schedule II banks. Schedule I banks, for the most part domestically owned, are widely held (no single owner may control more than 10 percent of the banks' voting stock). Schedule II banks are closely held; many are owned by their foreign parent financial institutions. The Act allows the government to control the size of Schedule II banks, except for U.S.-owned Schedule II banks, which are exempt, in keeping with the provisions of the North American Free Trade Agreement.

The 2007 amendment to the *Bank Act* resulted in a number of changes to acts governing financial institutions, including the *Bank Act*, the *Cooperative Credit Associations Act*, the *Insurance Companies Act*, and the *Trust and Loan Companies Act*.

The *Insurance Companies Act* (1991) is designed to help protect insurance purchasers by setting out guidelines for insurance companies. The Act provides details regarding insurance and its applicability with incorporation, continuance and discontinuance, capital structure, corporate governance, ownership, business and powers, investments, and other relevant topics.

The *Trust and Loan Companies Act* (1991) outlined the rules regulating trust and loan companies in Canada.

The *Canada Deposit Insurance Corporation Act* (1967) established the CDIC to protect depositors and to promote the stability of the financial system in Canada. The Corporation reports to Parliament through the Minister of Finance, and its objectives are to provide insurance against the loss of part or all of deposits and to promote and otherwise contribute to the stability of the financial system in Canada.

The *Cooperative Credit Association Act* (1970) established the rules regulating Cooperative Credit Associations. These associations are organized and operated on cooperative principles, with one of its principal purposes being to provide financial services to its members.

The *Canadian Payments Act* (1980) established the Canadian Payments Association as a regulated public-purpose organization, with a mandate to establish and operate a national clearings and settlement system and to plan the evolution of the national payments system. In June 2001, the Act was revised to update and refine the Canadian Payments Association's mandate, expanded the membership, and added new governance features.

The *Financial Consumer Agency of Canada Act* (2001), established the FCAC as an agency responsible for strengthening the oversight of consumer protection measures in the federally regulated financial sector. The federally regulated Canadian financial services sector includes all banks and all federally incorporated or registered insurance, trust and loan companies, and cooperative credit associations. The Act outlines FCAC's functions, administration, and enforcement powers.

The *Office of the Superintendent of Financial Institutions Act* (OSFI) (1987) created a single regulatory agency responsible for the regulation and supervision of all federally chartered, licensed, or registered banks, insurance companies, trust and loan companies, cooperative credit associations, and fraternal benefit societies. In addition, it established the Financial Institutions Supervisory Committee (FISC), composed of the Superintendent of Financial Institutions, the Governor of the Bank of Canada, the Deputy Minister of Finance, the Chairperson of the CDIC, and the Commissioner of the FCAC. FISC was created to simplify and enhance the confidential exchange of information among its members on all matters related to the supervision of financial institutions.

Nonstatutory Elements

Provincial securities regulators delegate certain aspects of securities regulation to self-regulatory organizations (SROs), such as the Investment Dealers Association of Canada (IDA), the Mutual Fund Dealers Association of Canada (MFDA), and Market Regulation Services, Inc.

Mutual Fund Dealers Association of Canada (MFDA)

The MFDA was established in 1998 by the Canadian Securities Administrators and is an SRO that regulates the operations, standards of practice, and business conduct of its members and their representatives, with a mandate to enhance investor protection and strengthen public confidence in the Canadian mutual fund industry. The MFDA is recognized as an SRO by the majority of the provinces and is responsible for the distribution side of the mutual fund industry.

The MFDA Investor Protection Corporation (IPC) is a not-for-profit corporation and is a separate legal entity from the MFDA. The MFDA IPC provides protection to eligible customers of MFDA Members on a discretionary basis to prescribed limits, if securities, cash, and other property held by any such member are unavailable as a result of the member's insolvency. Responsibility for regulation of the funds or the fund manufacturers remains with the securities commissions.

The IDA, TSX Group, and the Montreal Exchange sponsor the Canadian Investor Protection Fund, a trust fund that was established in 1969 to protect investor assets in the event of the insolvency of an SRO member firm.

Investment Dealers Association (IDA)

The IDA is the national SRO of the securities industry, whose members include more than 200 investment dealers. The IDA regulates the activities of investment dealers in terms of both their capital adequacy and conduct of business.

In 2007, member firms of the IDA voted for a merger with RS Market Regulation

Services, Inc., and a new SRO, provisionally, New Regco,[4] was formed.

Institutional Structure of the Regulators

As mentioned, the current Canadian financial regulatory structure can be described as an integrated and functional hybrid, because it has characteristics of both integrated and functional systems.

Department of Finance

The Department of Finance drafts legislation governing federal financial institutions to ensure they are safe and sound, and determines the regulatory framework for banking and other financial services. Established under the *Financial Administration Act,* it is led by the Minister of Finance, who is appointed by the Prime Minister. The Department receives most of its funding through annual Parliamentary appropriations. Parliament approves resources to the Department, including voting on appropriations and statutory authorities for both budgetary and non-budgetary items. The Department of Finance participates in the Financial Institutions Supervisory Committee (FISC).

Bank of Canada

The Bank of Canada was founded in 1934 as a privately owned corporation. In 1938, it became a Crown corporation belonging to the federal government. The Bank of Canada is the nation's central bank, with responsibilities for Canada's monetary policy, bank notes, financial system, and funds management.

The Bank regulates financial markets largely through its influence on interest rates, and acts as a lender of last resort (LOLR). The Bank of Canada has rarely had to extend Emergency Lending Assistance (ELA) as the LOLR to financial institutions.[5]

The Bank of Canada is under the management of a Board of Directors composed of a Governor, a Deputy Governor, and 12 directors appointed by the Minister of Finance. The Governor and Deputy Governor are appointed by the directors with the approval of the Governor in Council (the Governor General of Canada acting by and with the advice and consent of the Queen's Privy Council for Canada). They are appointed to seven-year terms. Directors are appointed to three-year terms and may be reappointed. The Deputy Minister of Finance sits on the Board as a nonvoting member.

The majority of the Bank's revenue is investment income earned on its portfolio of government securities. Most of this revenue is paid to the Government of Canada; a small portion is used each year to finance the Bank's general operating expenses.

Office of the Superintendent of Financial Institutions (OSFI)

OSFI was established in 1987 and reports to the Minister of Finance. OSFI is the

---

4 This merger has not been approved as yet by the Canadian Securities Administrators.

5 In the last 30 years, there have been a small number of examples of ELA to federal chartered banks in Canada. The first involved Unity Bank of Canada and occurred in 1977. In that case, the Bank of Canada provided ELA over a three-month period. Unity Bank was merged with the Provincial Bank of Canada. The second case involved two banks, the Canadian Commercial Bank and the Northland Bank, and occurred in 1985. These two small regional banks were supplied with ELA over a six-month period, at the end of which authorities concluded that neither bank was viable and they were liquidated. A number of other small regional banks also received ELA in the aftermath of the closure of the two banks.

primary supervisor of federally chartered financial institutions and federally administered pension plans. It is an independent institution, and although it reports to the Minister of Finance, on certain key matters OSFI retains sole responsibility for its judgments and actions, notably decisions and actions related to prudential supervision. This leading role in prudential supervision is underscored by the Superintendent's position as Chair of the Financial Stability Committee.

The Superintendent of Financial Institutions is appointed by the Governor in Council to a seven-year term. The Superintendent is responsible for exercising the authorities under the financial legislation, and is required to report to the Minister of Finance on the administration of the financial institutions' legislation. OSFI is funded mainly through asset-based, premium-based, or membership-based assessments on the financial services industry and related fees for selected services. A small portion of OSFI's revenue is derived from the Government of Canada, primarily for actuarial services relating to Canadian pension programs and public sector pension and benefit plans.

Canada Deposit Insurance Corporation (CDIC)

The CDIC is a federal Crown corporation created by Parliament in 1967. Its mandate is to protect depositors and to promote and otherwise contribute to the stability of the financial system in Canada. CDIC member institutions pay premiums to CDIC to cover the cost of insuring deposits. In the event of a failure, CDIC pays depositors the amount of their insured savings—up to $100,000 in each of six categories of CDIC deposit insurance coverage.

The CDIC's Board of Directors consists of a Chairperson, five ex officio directors, and five private sector directors. The Chairperson of the CDIC is appointed by the Governor in Council to serve for a defined term pursuant to the *CDIC Act*, unlike the other private sector directors who serve pursuant to the provisions of the *Financial Administration Act*. The ex officio directors consist of officials from the Bank of Canada, the Department of Finance, OFSI, and the FCAC.

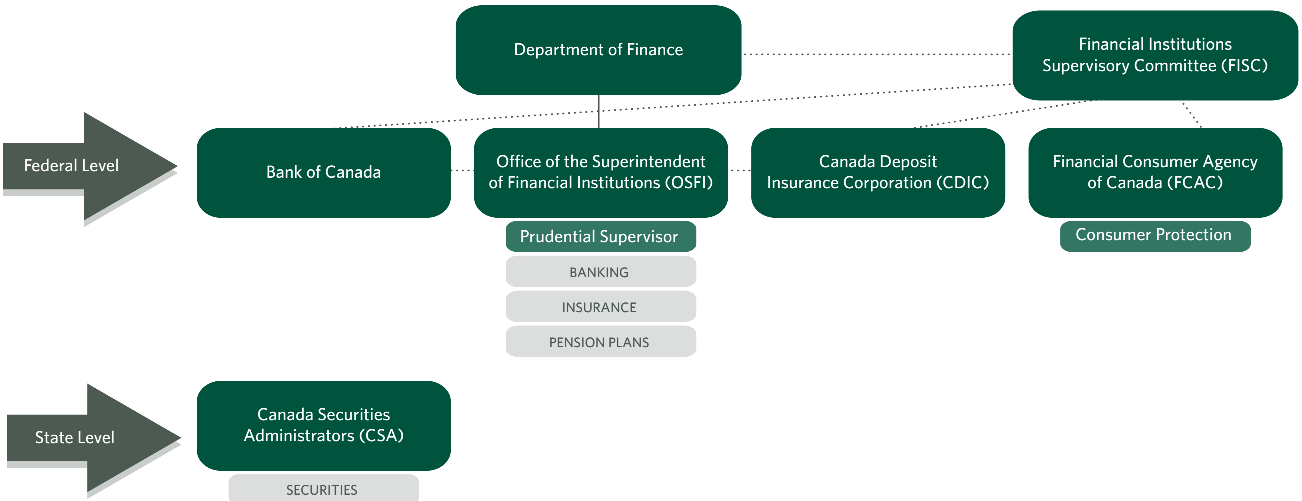
Membership in the CDIC is limited to banks, federally incorporated trust and loan companies, provincially incorporated trust and loan companies, and retail associations within the meaning of regulations promulgated under the *Cooperative Credit Associations Act*. The CDIC automatically insures deposits in federal institutions that are authorized to take retail deposits.

The CDIC is funded by premiums that are assessed on the insured deposits of member institutions. The CDIC does not receive federal tax dollars to carry out its operations.

Securities Regulators

The 10 provinces and three territories in Canada are responsible for securities regulations. Securities regulators from each province and territory form the Canadian Securities Administrators (CSA). The CSA is primarily responsible for developing a harmonized approach to securities regulation across the country. In recent years, the CSA has developed a system that designates one securities regulator as the lead agency when it comes to reviewing applications or disclosure documents from companies that report to more than one jurisdiction. The purpose of this system is to increase market efficiency by streamlining the process and

FIGURE 8. **The Financial Services System Regulatory Structure, Canada**



Note: Dotted lines indicate a cooperative relationship.

reducing the number of regulatory agencies with which a given company must deal.

While the CSA coordinates initiatives on a cross-Canada basis, provincial or territorial regulators handle all complaints regarding securities violations in their respective jurisdictions. Enforcement of securities regulations for individual firms is also done on an individual basis by each province or territory.

Figure 8 provides a graphic depiction of the relationship among the above-mentioned institutions.

Enforcement

The OSFI and the CDIC have numerous mechanisms by which they can intervene in the case of a failing institution. These are laid out by the OSFI and the CDIC in a *Guide to Intervention for Federal Financial Institutions*. The *Guide* provides a framework for responding effectively to circumstances that could lead to the instability of a financial institution. There are four stages of intervention: (1) when deficiencies are first detected, that is, early warning; (2) when there is a risk to viability or solvency of the institution; (3) when viability or solvency of an institution is in serious doubt; and (4) and when nonviability or insolvency is imminent. Each stage is associated with an increasing level of intervention that can be undertaken by the OSFI. Interventions taken at each stage are coordinated with CDIC, and other agencies are kept informed via the FISC.

OSFI's level of intervention gradually escalates in severity and can include formal notification to management, meeting with management, or monitoring an institution on an escalating basis; requiring the institution to increase capital; requiring a special audit; restricting the institution's business; seeking a possible buyer; taking control; or after taking control, OSFI can seek a winding-up order by a court, at which point a liquidator, which is not OSFI, can be appointed.

After reports of major corporate fraud and misconduct in the United States in 2001/2002, actions were taken in Canada by governments, regulators, and industry to foster investor confidence in capital markets. The federal government adopted a coordinated national enforcement approach to strengthen the investigation and prosecution of serious corporate fraud and market illegality, which included the creation of integrated market enforcement teams (IMETs) with the Royal Canadian Mounted Police in Canada's major financial centers. Six IMETs are currently operational in Canada.

As a regulatory agency, the Financial Consumer Agency of Canada (FCAC) can exercise its enforcement powers to ensure that financial institutions comply with the consumer provisions of the various federal acts relating to financial services. In cases of contravention or noncompliance, it notifies the financial institution of a violation. It may also, depending on the severity and frequency of the problem, seek a commitment from the financial institution to remedy the issue within a short time frame, impose a monetary penalty, impose criminal sanctions, or take other actions as necessary.

Framework for Domestic Coordination

The Financial Institutions Supervisory Committee (FISC) was established in 1987 pursuant to the *Office of the Superintendent of Financial Institutions Act*. Its membership consists of the Superintendent of Financial Institutions (who acts as chair), the Deputy Minister of Finance, the Governor of the Bank of Canada, the chairperson of the CDIC, and the Commissioner of the FCAC. The FISC meets regularly to discuss matters related to the supervision of financial institutions. It is also a forum for consultation and information exchange on supervisory matters that have implications for solvency, last-resort lending, and the risk of deposit-insurance payout. The FISC is intended to give the Superintendent of OSFI, who is responsible for judgments pertaining to the viability and solvency of federal financial institutions, the full benefit of views of the deposit insurer and the lender of last resort when making supervisory decisions. The FISC also serves as a forum to coordinate strategies of its member agencies when dealing with troubled institutions.

The Bank of Canada has the ability to inject liquidity in its role as LOLR and via its emergency lending role. It can inject liquidity into a broad range of financial institutions if the Governor, in consultation with FISC colleagues, determines it is necessary to ensure the safety and soundness of Canada's financial system. However, in recent years the Bank of Canada has not had to exercise this ELA role.

The FISC provides the principal forum in which issues related to financial stability and possible bank failures are discussed. Its membership includes the leaders of all the key supervisory agencies: the Department of Finance, the Bank of Canada, the OSFI, the CDIC, and the FCAC. The Superintendent of OSFI chairs the FISC.

The FISC meets regularly to address financial stability, supervision, and LOLR matters. The FISC met daily during recent turmoil in the asset-backed commercial paper market in Canada. Much of the debate in the FISC is, by necessity, initially not disclosed to the public.

Canadian regulators do not have a formal Memorandum of Understanding (MoU) with respect to the intervention of financial institutions; however, the OSFI and the CDIC have the *Guide to Intervention for*

Federal Financial Institutions, which provides a framework for coordination. Supervisors also have the Senior Advisory Committee (SAC), a body that provides a forum from within which broader questions of overall system policy development and implementation can be debated. The SAC is led by the Department of Finance, and its membership is the same as the FISC.

Regulators coordinate on combating money laundering and terrorist financing. The OSFI and others have signed an MoU with the Financial Transactions Reports Analysis Centre of Canada.

The Joint Forum of Financial Market Regulators, founded in 1999 by the Canadian Council of Insurance Regulators, the Canadian Securities Administrators (CSA), and the Canadian Association of Pension Supervisory Authorities, and including representation from the Canadian Insurance Services Regulatory Organizations, was established as a mechanism through which pension, securities, and insurance regulators could coordinate, harmonize, and streamline the regulation of financial products and services in Canada.

International Coordination

Please refer to the chart of international coordination activities and organizational participation on page 234.

Current Issues

Debate continues in Canada over the reform of the current regulatory framework for Canadian securities markets. In 2003, the Wise Persons' Committee was established by the Minister of Finance of Canada to undertake an independent, objective review of the current securities regulatory framework. The committee recommended that a single regulator built on joint federal-provincial participation replace the current system of provincial regulation. This has yet to be implemented. In 2005, the Crawford Panel recommended a Canadian Securities Commission.

Another structural and supervisory issue that is being debated concerns the drafting of legislation that would permit the creation of a bridge bank by the CDIC. A bridge bank is a temporary banking structure put in place and maintained by the government, designed to take over the operations of a failing bank in order to maintain services to its customers.[6] The CDIC and its supporters believe that such a facility would provide further assurance to depositors after the closure of a failed institution.

6 Nicholas J. Ketcha, Jr., "Deposit Insurance System Design and Considerations," Bank for International Settlements, Basel, November 1999, www.bis.org/publ/plcy07o.pdf.

ACRONYMS AND ABBREVIATIONS

CDIC	Canada Deposit Insurance Corporation
CSA	Canadian Securities Administrators
DOI	Department of Insurance
ELA	Emergency Lending Assistance
FCAC	Financial Consumer Agency of Canada
FISC	Financial Institutions Supervisory Committee
IDA	Investment Dealers Association
IMETs	Integrated market enforcement teams
IPC	Investor Protection Corporation
LOLR	Lender of last resort
MFDA	Mutual Fund Dealers Association of Canada
MFDA IPC	MFDA Investor Protection Corporation
MoU	Memorandum of Understanding
OIGB	Office of the Inspector General of Banks
OSFI	Office of the Superintendent of Financial Institutions
SAC	Senior Advisory Committee
SRO	Self-regulatory organization

GERMANY

Market Description

The Deutsche Bundesbank and the German Financial Supervisory Authority (BaFin) currently supervise approximately 2,079 banking institutions and 718 financial services institutions, 633 insurance undertakings, 26 pension funds, 6,000 investment funds, and 78 investment companies. The supervised banks are categorized into four large groups: lending banks, savings banks, cooperative banks, and other (building societies, mortgage banks, securities trading banks, and both the federal and state housing promotion banks).[1]

The German banking system has the lowest level of concentration, or level of market share held by a small number of financial institutions, in Europe. The traditional three-tier banking system in the Federal Republic of Germany, consisting of private, public-sector, and co-operative banks, is slowly being transformed. Further changes are likely as a result of the elimination of the Landesbanken's public guarantees (Gewährträgerhaftung) and the modification to maintenance obligation (Anstaltslast) in 2005.

Background

The German regulatory structure is characterized as an integrated regulatory structure. Prior to 2002, Germany's financial regulatory system was institutional in its approach. The Federal Banking Supervisory Office (BaKred) regulated banking, the Federal Securities Supervisory Office (BaWe) was in charge of securities, the Federal Insurance Supervisory Office (BAV) regulated insurance, and state regulators supervised stock exchanges. In 2002, the *Bundesbank Act* (the central bank act) was amended, to take account of the fact that Germany had adopted the euro, thereby reducing the powers of the Landeszentralbanken (state central banks) in the central banking system. At the same time, the government reevaluated the institutional nature of the banking supervision system since it no longer suited the evolving financial services market. Growing integration of the financial sector had led to blurred boundaries across financial services sectors and an overlap in products, services, and supervisory functions.

A key part of the reform was restructuring supervision under one institution—the newly created integrated supervisor, the Bundesbank and the German Federal Financial Supervisory Authority (BaFin)—which replaced the three institutional supervisors, the BaKred, the BaWe, and the BAV. However, the Bundesbank is assigned most of the operational tasks in banking supervision. To avoid duplication of work, the Bundesbank and the BaFin have spelled out the details of their respective roles in day-to-day supervision in an agreement.

After World War II, the military governments of the Western Allies assigned regulatory powers to the newly created Bundesländer (the individual Federal States within Germany's new federal system). The Federal States performed the functions of banking supervision, together with their respective Federal-State central banks (Landeszentralbanken). To coordinate their activities, in 1949 the Landesregierungen (governments of the Bundesländer) established a Special Banking Supervision Committee, bringing together representatives of all banking supervisory authorities, including Federal ministry representatives. The Bundesbank was established in 1957

---

[1] www.bafin.de

as the sole successor to the two-tier central bank system, composed of Bank Deutscher Länder and the Landeszentralbanken, former legally independent bodies. Together, these institutions bore responsibility for the German currency from June 1948, when the Deutsche Mark was introduced, until the Bundesbank was founded.

Throughout the 1950s, discussions continued to address problems relating to legal and jurisdictional ambiguity. In 1961, the *Banking Act* was passed, creating the legal basis for the establishment of the Federal Banking Supervisory Office (BaKred). During 1962–2002, the BaKred saw the number of supervised credit institutions decrease from approximately 13,000 to 2,600, while the number of branches expanded from 18,000 to 51,000.

The BaKred's powers increased as a result of a banking crisis in 1974, when a Cologne-based bank, Herstatt, failed. The banking law was amended to authorize the BaKred to issue a temporary moratorium on a bank in financial difficulties or to conduct special audits without particular cause. The changes also included more stringent provisions concerning large exposures and the introduction of the principle of dual control for senior management or directors.

Federal securities supervision was created as a result of the *Second Financial Market Promotion Act*, adopted in 1994. This legislation provided a federal body to supervise securities markets and prompted a far-reaching reform of Germany's securities markets regulation. The main goal of the reform was to bolster the efficiency of Germany's financial sector, enhancing its ability to compete within the international arena. One of the key elements of the reform was the establishment of the Federal Securities Supervisory Office (BaWe) in 1995.[2] Almost all provisions of Germany's *Securities Trading Act* are based on European directives.[3]

With the end of World War II, unified insurance supervision collapsed. The Reich Insurance Supervisory Office ceased to exist, and the Occupying Powers assumed responsibility for insurance supervision. However, by the end of 1945, attempts were being made to reestablish insurance supervision. The fragmentation of insurance supervisory activities in postwar Germany was also considered to be counterproductive. Those involved in the debate surrounding a general overhaul of legislation agreed that the *Insurance Supervision Act* of 1901 should remain intact. However, there were differing views as to whether public insurers should also be subject to official supervision. In 1951, the BAV was established, paving the way for the creation of a federal office for the supervision of the insurance sector and of building and loan associations.[4] The BAV was responsible for the supervision of both private and public insurance undertakings engaged in competitive business operating in more than one region of the country.[5]

Statutory Framework

The *Banking Act* is the primary legal basis for the supervision of banks, and has been amended on a number of occasions since it

2 Germany's *Securities Trading Act* of 1995.

3 "History of Securities Supervision," www.bafin.de.

4 In 1973, supervision of building and loan associations came under the jurisdiction of the BaKred, following the adoption of the *Building and Loan Associations Act*.

5 "History of Insurance Supervision," www.bafin.de.

first came into effect in 1962. A number of specific acts further define the supervisory environment, such as the *Mortgage Bonds Act, the Securities Deposit Act*, the *Building and Loan Associations Act*, and the *Savings Banks Acts of the Federal States*. In 1985, the Third Amendment to the *Banking Act* was passed. Various amendments followed, seeking to align German law with other European Union (EU) directives.

In 1998, the Sixth Amendment to the *Banking Act* implemented additional EU directives. It also empowered the BaKred with the necessary regulatory tools to combat unauthorized banking business and financial services as part of its extended scope of supervision. In mid-2002, banking supervision had become a directorate within the newly established BaFin.

The legislation relating to the supervision of securities includes the *Securities Trading Act*, the *Securities Acquisition and Takeover Act*, the *Securities Prospectus Act*, and the *Prospectus Act*. For asset management, the BaFin supervises the financial services institutions and investment companies on the basis of the *Banking Act* and the *Investment Act*.

The *Third Financial Market Promotion Act of 1998* granted additional broad powers to obtain information relative to insider trading, and extended the notification requirements for shareholders in exchange-listed enterprises. In 2002, the BaWe was assigned the task of monitoring corporate takeovers, in line with the newly enacted *Securities Acquisition and Takeover Act*. The *Fourth Financial Market Promotion Act* of 2002 further realigned the scope of supervision, and the BaFin is now responsible for monitoring the prohibition on price and market manipulation.

Nonstatutory Elements

In Germany, industry associations exist in every sector of the finance business. They represent and promote the interests of their members in all matters relating to financial policy. The associations also provide best practice rules that apply to all their members, and additional voluntary deposit protection schemes for the banking sector. The voluntary protection schemes of the associations enhance the guarantee on customer deposits beyond statutory requirements. Industry associations include:

- The Association of German Banks;
- The Association of German Public Sector Banks;
- The German Savings Banks Association;
- The Association of German Cooperative Banks ;
- The German Investment and Asset Management Association; and
- The German Insurance Association.

Institutional Structure of the Regulators

The German regulatory structure is characterized as an integrated regulatory structure.

Ministry of Finance

BaFin is subject to the legal and technical oversight of the Federal Ministry of Finance, which monitors BaFin's administrative actions for legality and fitness of purpose.

Financial Supervisory Authority (BaFin)

The BaFin was established in 2002 as the integrated financial supervisor in Germany for the supervision of credit institutions and financial services providers, insurance undertakings, and securities trading. Its primary objective is to guarantee the proper functioning, stability, and integrity of the German financial system.

The BaFin's mission is to counteract undesirable developments in the banking and financial services sector that may endanger the safety of the assets entrusted to institutions or that might impair the proper conduct of banking business, provision of financial services, or involve serious disadvantages for the national economy. Through its securities supervision, the BaFin also enforces standards of professional conduct that aim to preserve investor trust in the financial markets. The BaFin also has an investor protection role and seeks to prevent unauthorized financial activities. Operators of exchange-like trading systems are subject to the same solvency supervision by the BaFin as credit institutions and financial services institutions.

The two primary objectives of insurance supervision are to ensure that the interests of policyholders are adequately safeguarded and that the obligations arising under insurance contracts can be met at all times. The BaFin supervises private insurance undertakings of material economic significance, and public insurance undertakings engaging in open competition that operate across the border of any Federal State. The Federal States mainly supervise public insurers whose activities are limited to the Federal State in question and to those private insurance undertakings of lesser economic significance. Since 2004, domestic undertakings engaging in the reinsurance business have also been subject to unlimited insurance supervision by the BaFin. Social insurance institutions (that is, statutory health insurance funds, the statutory pension insurance fund, statutory accident insurance, and unemployment insurance) are not subject to supervision by the BaFin, but are regulated by other government agencies.

BaFin is an independent body governed by public law. Its Administrative Council oversees management and is responsible for deciding the BaFin's budget. The Administrative Council is composed of 21 members, chaired by the Federal Ministry of Finance, and includes representatives from the Federal Ministry of Finance and other ministries, the Bundestag, credit institutions, and insurance and investment companies.[6] In 2008, the management structure for day-to-day operations was changed from having authority rest solely with the President of the BaFin to a Board of Directors, consisting of the President and four Chief Executive Directors.

An Advisory Council, which meets twice a year, also aids the BaFin in general matters related to its further development of supervisory law. The 24 members of the council are drawn from academia, the supervised undertakings, consumer protection associations, and the Deutsche Bundesbank.

Separate organizational units were created for supervision of banking, insurance, and securities/asset management. There is cross-sectoral coordination across functional areas necessitated by developments in the financial markets, carried out by several cross-sectoral departments that are organizationally separated from the traditional supervisory functions. The tasks

[6] BaFin Annual Report 2006, p. 227.

of these departments include coordination of the work in international supervisory forums, risk analysis and financial market studies, consumer and investor protection, and the fight against money laundering across all sectors.

In 2006, the BaFin employed approximately 1,600 people. It does not receive any funding from the federal budget; rather, it is financed by cost allocation payments (2006 estimate: €106 million) and fees, including separate reimbursements (2006 estimate: €18.9 million) from the companies subject to supervision.[7]

The Deutsche Bundesbank

The Bundesbank is the central bank of the Federal Republic of Germany, and it plays an important role in virtually all areas of banking supervision.[8] The Bundesbank is responsible for ongoing supervision (evaluations of bank reports, annual accounts and auditor reports, interviews, onsite examinations, and so forth), with the exception of (sovereign) individual regulatory measures vis-à-vis institutions, which are reserved for the BaFin, prudential audits, and international cooperation/coordination in the prudential field. In addition, the Bundesbank plays an important role in crisis management. In exercising its powers, the Bundesbank is independent of and not subject to instructions from the Federal Government. The Bundesbank advises the Federal Government on monetary policy issues of major importance.

The Bundesbank's decision-making body is the Executive Board. It comprises the President, the Vice-President, and four other members (due to a transition period, there are currently five other members). Its mandate is to govern and manage the Bundesbank. The members of the Board are appointed by the President of the Federal Republic. The President, the Vice-President, and one other member are nominated by the German Federal Government, and the other three members are nominated by the Bundesrat (the upper house of Parliament) in agreement with the Federal Government. At the end of 2007, the Bundesbank had approximately 11,600 employees.[9]

Deposit Insurance

Germany has a statutory deposit protection system for deposits with any credit institution with a registered office in the Federal Republic of Germany. The amount of the claim to compensation is limited to 90 percent of the non-fulfilled claim and a maximum of €20,000 for each depositor. All deposit-taking credit institutions must by law join a statutory compensation scheme. In addition to the statutory protection, there are also private protection schemes run by the respective banking associations, which offer protection in excess of the statutorily prescribed degree of protection.

Bundesländer

The authorities of the Federal States (Bundesländer) supervise the individual stock exchanges, including the orderly conduct of trading on these exchanges, in accordance with the provisions of the *Stock Exchanges Act*. The BaFin cooperates with

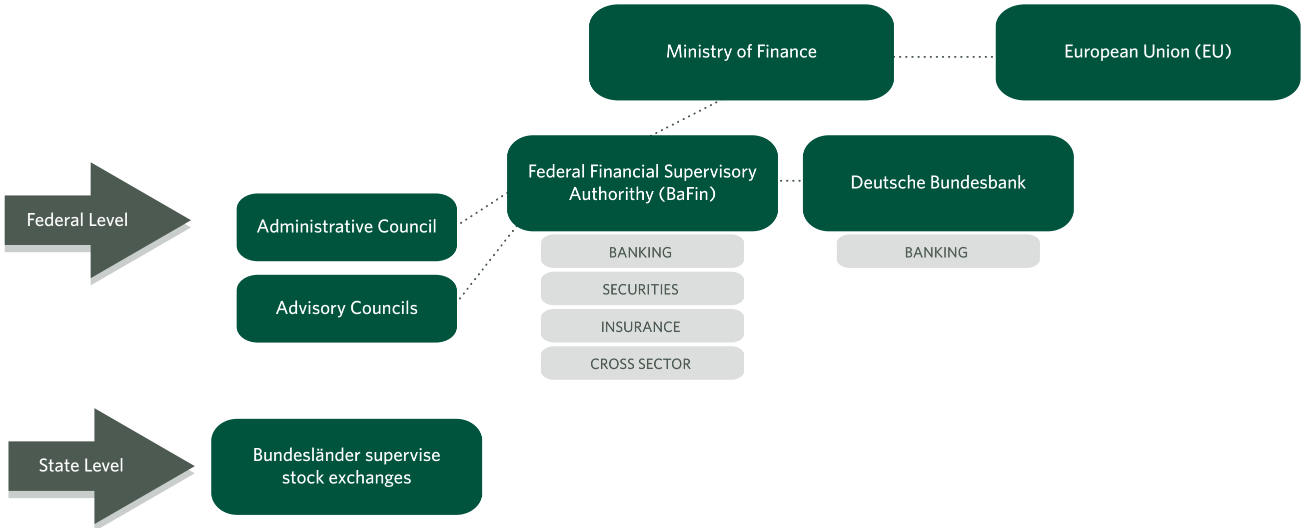
---

[7] Jahresbericht, BaFin Annual Report 2006.

[8] www.bundesbank.de/bankenaufsicht/bankenaufsicht_bafin.en.php.

[9] www.bundesbank.de.

FIGURE 9. The Financial Services System Regulatory Structure, Germany



Note: Dotted lines indicate a cooperative relationship.

the stock exchange supervisory authorities in fulfilling the functions of stock exchange regulator at the international level.

Figure 9 provides a graphic depiction of the relationship among the above-mentioned institutions.

Enforcement

The BaFin has wide-ranging powers of investigation and intervention, and has extensive powers to enforce the immediate cessation and closure of unauthorized business activities. Under the *Insurance Supervision Act*, the BaFin may issue any instructions that may be "appropriate and necessary" to prevent or eliminate undesirable developments that threaten to harm the interests of policyholders.

To address serious supervisory weaknesses in institutions, the BaFin can initiate consultations, order a special audit, impose higher capital requirements, freeze the institution, revoke licenses, and replace management and/or the institution's Board of Directors.

Framework for Domestic Coordination

The Deutsche Bundesbank cooperates with the BaFin in ongoing banking supervision, as stipulated by section 7 of the *Banking Act*. Both organizations spelled out the details of their respective roles in day-to-day supervision in a February 2008 updated Supervisory Guideline (Guideline on the execution and quality assurance of the ongoing supervision of credit and financial services institutions by the Deutsche Bundesbank). Under this agreement, the Bundesbank is assigned most of the operational tasks in banking supervision. In the ongoing monitoring process, the Bundesbank's responsibilities include evaluating the documents, reports, annual accounts, and auditors' reports submitted by the institutions, and regular audits of banking operations. It holds both routine and ad hoc prudential discussions with the institutions. The BaFin, on the other hand, is responsible for all sovereign measures.

The Deutsche Bundesbank, the BaFin, and the Federal Ministry of Finance meet regularly in the Forum for Financial Market Supervision with the aim of coordinating the supervision of enterprises operating in the financial markets and enhancing existing concepts of supervision, in particular against the backdrop of current market developments. Formal discussions among the three institutions are supplemented by information exchange.

In addition, Germany has established a Domestic Standing Group for financial market stability and crisis management. This body has developed a general framework for crisis management; however, this framework is not made public. Bearing in mind that each financial crisis will be different, the arrangements are flexible.

Since unauthorized businesses are becoming increasingly international, the BaFin cooperates not only with the Federal Office of Criminal Investigation and its Bundesländer counterparts, but also with the regulatory and criminal prosecution authorities of other countries.

International Coordination

Please refer to the chart of international coordination activities and organizational participation on page 234, and to the European Union profile for an explanation of coordinating activities within the EU.

Current Issues

No current issues have been noted.

ACRONYMS AND ABBREVIATIONS

BaFin	Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht)
BaKred	Federal Banking Supervisory Office (Bundesaufsichtsamt für das Kreditwesen)
BAV	Federal Insurance Supervisory Office (Bundesaufsichtsamt für das Versicherungswesen)
BaWe	Federal Securities Supervisory Office (Bundesaufsichtsamt für den Wertpapierhandel)
EU	European Union

JAPAN

Market Description

The Japanese financial system is notable for the large role that deposit-taking institutions continue to play in financial intermediation. In the 1980s, bank loans constituted more than 30 percent of all corporate liabilities.[1] Although the percentage has declined since then, reflecting the shift to direct fundraising from the market, bank loans still constitute 18 percent of all liabilities. The large role of deposit-taking institutions in financial intermediation is also reflected in the size of their assets and liabilities, which constitute more than 50 percent of the sum of assets and liabilities of all financial intermediaries.[2] As of March 2007, there were 618 financial institutions insured by the Deposit Insurance System, including 147 banks and 455 cooperative-type deposit-taking institutions (including 287 Shinkin banks and 168 credit cooperatives).[3]

There are five city banks, four of which (Mizuho Bank, Mizuho Corporate Bank, Sumitomo Mitsui Banking Corporation, and Bank of Tokyo-Mitsubishi UFJ) have a combined total banking asset share of around 35 percent. The total assets within banking were approximately ¥761 trillion (Japanese yen). The Japan Post Bank is still undergoing privatization, which is planned to be achieved by 2017. Among non-bank financial institutions, the market for moneylenders registered with the Financial Services Agency (FSA) is classified broadly into 12 categories, by type of operations.[4] In 2006, there were 9,066 such companies. The market size of the non-bank business, particularly the consumer credit business, is generally measured based on the loan balance, which was about ¥41 trillion in 2006.[5]

Historically, securities companies in Japan operate mainly as dealers (including retail stock subscriptions and trades). They

---

1 Flow of Funds statistic base.

2 Ibid.

3 *Shinkin Banks*: Shinkin banks are cooperative financial institutions whose membership is composed of local residents and small and medium-sized companies. Shinkin banks' distinctive characteristics are (a) they are close and convenient, (b) they have fine-tuned and personalized services, and (c) they have a strong relationship of mutual trust with their customers and communities. Shinkin banks limit their lending, in principle, to members; however, their functions are almost the same as those of commercial banks, and they also deal with many people who are not members, accepting deposits, providing exchange services, accepting various payments including those for public utilities, and engaging in over-the-counter sales of public bonds, investment trusts, and insurance.
Credit Cooperatives: Credit cooperatives are not-for-profit cooperative financial institutions owned and managed by their members, and they offer various financial services (such as commercial banks) for their members. Originally, credit cooperatives were founded for the purpose of mutual financial aid among their own communities. Generally, credit cooperatives are divided into three groups, each having members that share common bonds in membership: (a) residency, (b) type of business, or (c) occupation (workplace).
Labor Banks: Labor Banks are organized and managed under the *Labor Bank Law*, enacted in 1953, which states: "The objectives of this law are to establish a Labor bank system jointly organized by trade unions, consumers' livelihood cooperatives, and other worker's organizations, to plan smooth financing of the welfare and mutual-aid activities of such organizations, thereby contributing to their healthy growth, as well as to improve the economic status of workers."

4 These types of operations are as follows: (a) consumer unsecured loan companies (major companies with a loan balance of more than ¥50 billion, and others); (b) consumer secured loan companies; (c) consumer residential loan companies; (d) business loan companies; (e) bill dealers; (f) credit card companies; (g) credit loan companies; (h) retail distributor/manufacturer-affiliated loan companies; (i) construction companies and realty dealers; (j) pawnbrokers; (k) leasing companies; and (l) "Nippu" loan companies (dealing with short-term loans for small, self-employed business owners).

5 "Statistical Data Related to Moneylending Business — Movement of the Loan Balance by Type of Operations/ Business Condition of Moneylenders by Type of Operations," www.fsa.go.jp/en/index.html.

are generally not engaged in investment banking activities. The three major securities companies (Nomura Securities Co., Ltd., Daiwa Securities Co., Ltd., and Nikko Citigroup Limited) do engage in some investment banking activities as a part of their operations, but they engage in far more dealer activities for personal securities trades.

The life insurance industry has 41 life insurance companies that currently operate in Japan. Of the 41 companies, 12 are foreign-affiliated companies and 4 are foreign branches. The total assets were ¥220 trillion in 2006.[6] The market in Japan is broadly shared by the so-called "Big Ten"[7] and 31 other companies. The Big Ten companies had a combined industry total asset share of around 80 percent for the past three years. The share of the Big Ten is decreasing while that of the 31 other companies has been gradually expanding. The publicly owned Japan Post Insurance, as mentioned, continues to undergo gradual privatization, which is expected to be achieved by 2017.

With regard to the property and casualty insurance industry, the total assets[8] held by the 23 domestic companies (excluding companies specialized in reinsurance business) were approximately ¥35 trillion in 2006. The six largest property and casualty companies, referred to as the "Big Six,"[9] controlled about 90 percent of total assets in 2006.

Background

Japan is characterized as having an integrated regulatory structure. The reform of the previous supervisory system into an integrated system was a reaction to perceived weaknesses in the traditional inspection and supervisory practices of the Ministry of Finance (MOF), which emphasized consultation and administrative guidance, often called the "convoy system." Regulatory reform was spurred by economic events, namely the gradual deflation of the economic boom of the late 1980s, which by the 1990s had resulted in stagflation, and saw the collapse of a number of banks. Hokkaido Takushoku Bank, one of the city banks in Japan, went bankrupt in 1997. Yamaichi Securities Co., Ltd., one of the Japanese Big Four securities companies at that time, closed its business, and in 1998, the Long-Term Credit Bank of Japan and The Nippon Credit Bank, Ltd. failed. Policymakers from the Diet felt that a new supervisory structure and approach was needed to ensure that individual bank's problems did not develop into a broader systemic or financial crisis.

To consolidate the supervisory system into a more effective one and to deal with the banking crisis, various institutional

[6] Based on data from "Insurance for 2007—Statistics of Life Insurance Business in Japan, 2006," published by the Insurance Research Institute.

[7] The Big Ten are (a) Nippon Life Insurance Co., (b) Meiji Yasuda Life Insurance Co., (c) Dai-ichi Mutual Life Insurance Co., (d) Sumitomo Life Insurance Co., (e) Mitsui Life Insurance Co., (f) Daido Life Insurance Co., (g) Asahi Mutual Life Insurance Co., (h) Fukoku Mutual Life Insurance Co., (i) AXA Life Insurance Co., Ltd., and (j) Taiyo Life Insurance Co.

[8] The market share analysis for the general insurance industry is generally made based on the "premium income." The analysis here is based on the "total assets" for the comparison with other industries.

[9] These companies are (a) Tokio Marine & Nichido Fire Insurance Co., Ltd., (b) Sompo Japan Insurance Inc., (c) Mitsui Sumitomo Insurance Co., Ltd., (d) Aioi Insurance Co., Ltd., (e) NIPPONKOA Insurance Co., Ltd., and (f) Nissay Dowa General Insurance Co., Ltd.

changes were implemented. The Financial System Reform in the late 1990s involved a big shift in the regulatory approach from ex ante regulation (limiting entry of financial intermediaries, restricting the types of financial services or products that could be provided) to ex post regulation (liberalizing entry while adopting measures to enhance transparency of financial transactions, investor protection rules). Many changes took place during this period of rapid reformation. There was liberalization of the entry into the various industries within the financial services arena. In 1996, the Prime Minister directed the Minister of Finance and the Minister of Justice to commence the "Japanese Big Bang," the overall reform of the financial system. The Japanese Big Bang was based on three principles—"free, fair and global"—aiming to increase the competitiveness of the Japanese financial market.

In 1998, a new integrated supervisor, the Financial Supervisory Agency[10] (FSA1), took over from the MOF the authority to inspect deposit-taking institutions (banks, Shinkin banks, credit cooperatives, and so forth), securities firms, and insurance companies. From 1998 to 2001, the Financial Reconstruction Commission (FRC) played a central role in the planning of failure resolution of, and capital injection to, financial institutions, and the FSA1 was positioned below the FRC. In 2001, the FRC was abolished and its functions were transferred to the FSA1, resulting in the present framework in which the FSA1 is the sole integrated regulator. In 2000, the authority for policy planning and implementation regarding the financial system was transferred from the MOF to the Financial Supervisory Agency, which changed its name to Financial Services Agency (FSA). After the creation of the FSA, the Bank of Japan retained its banking supervisory role via its private contracts with depositors.

Prior to the Japanese Big Bang in 1992, the Securities and Exchange Surveillance Commission (SESC) was established to supervise securities transactions. Today the SESC is a semi-independent body under the FSA. It conducts market surveillance and on-site inspections but does not have powers to impose administrative actions.

Statutory Framework

The experience in dealing with the Japanese financial crisis in the late 1990s led to the clarification of the role of financial authorities in case of a financial crisis.

The *Ministry of Finance Law* outlines the duties of the MOF.

The *Bank of Japan Law,* (Act No. 89 of 1997), defines the responsibility of the Bank of Japan for on-site examination and for providing lender-of-last-resort functions.

The *FSA Law* established the FSA and the SESC. It outlines the Agency's and the Commission's responsibilities and functions regarding supervision and inspection of financial institutions, surveillance of the securities markets, licensing, and other regulatory activities.

The *Deposit Insurance Law* protects depositors and provides assistance in mergers or other transactions involving failed institutions. Notwithstanding the provisions of the *Law Concerning Limitation of Public Financial Assistance to Corporate Entities,* the government may provide guarantees for liabilities with respect to funds borrowed by the Deposit Insurance Corporation of

[10] The MOF kept the function of managing the financial system during this time frame.

Japan (DICJ) or bonds issued by the DICJ, within the limits approved by a resolution of the Diet.

The *Financial Instruments and Exchange Law* of 2007 (FIEL) is a broadly revised version of the former *Securities and Exchange Law*.[11] The FIEL presents a uniform legal infrastructure for financial market transactions. Securities-related businesses by deposit-taking institutions and insurance companies are regulated under the FIEL based on the *Banking Law* and the Insurance Business Law.

Nonstatutory Elements

There are various self-regulatory components adopted by industry groups (voluntary associations), such as the Japanese Bankers Association, the Regional Banks Association of Japan, the National Association of Shinkin Banks, the Life Insurance Association of Japan, the General Insurance Association of Japan, the Japan Securities Dealers Association, the Commodity Futures Association of Japan, the Japan Financial Services Association, and the Japan Securities Investment Advisers Association. These industry groups were established to enhance the position of each industry in the economy and to protect their own interests through political lobbying.

In 1998, the Insurance Policyholders Protection Corporation of Japan, for life insurance, was established to support policyholders, in the event of the failure of life insurance companies, for the transfer of insurance policies, and for the payment of covered claims. All of the life insurance companies in Japan are currently members of this organization. Also in 1998, the Insurance Policyholders Protection Corporation of Japan, for property and casualty insurance, was established. In addition, the Investors Protection Fund was established to protect investors from losses incurred due to a failure of a securities firm.

Institutional Structure of the Regulators

The Japanese financial regulatory structure is characterized as an integrated approach led by the Financial Services Agency, with the Ministry of Finance and the Bank of Japan continuing to retain an important role. The Deposit Insurance Corporation of Japan is responsible for implementing practical measures such as reimbursement of insured deposits and financial assistance to reorganize failed banks.

Ministry of Finance (MOF)

The MOF is responsible for managing the government's budget and maintaining the credibility of Japanese currency and the stability of foreign exchange markets. The MOF's supervisory role is limited as a result of the establishment of the FSA, although it retains a role within the crisis management council. In addition, the MOF is responsible for the budgets of all of the country's public entities, including the FSA. The MOF has approximately 70,000 employees.

Bank of Japan (BOJ)

The objective of the BOJ, as the central bank, is to issue currency and to carry out monetary policy. In addition, the BOJ is responsible for financial stability to ensure effective settlement of funds. BOJ's principal supervisory role, the use

[11] Many securities-related laws are integrated with the FIEL, such as the Law on Investment Trust and the Investment Advisor Law.

of on-site examinations, enables it to fulfill its financial stability responsibility. These examinations are based on contractual relationships with all institutions that maintain deposits at the central bank. The institutions agree to on-site examinations by the BOJ. Such examinations allow the BOJ to maintain a detailed understanding of the day-to-day health of financial institutions, providing necessary information for the BOJ to conduct its lender-of-last resort functions.

The Board of the BOJ is composed of nine members, each with a five-year term: six Members of the Policy Board, the Bank of Japan's Governor, and two Deputy Governors. The Governor and Deputy Governors are appointed by the Cabinet, subject to the consent of the House of Representatives and the House of Councilors. The Members of the Policy Board are also appointed by the Cabinet, subject to the consent of the House of Representatives and the House of Councilors. The Governor appoints the BOJ's staff. The BOJ reports semiannually to the Diet.

Financial Services Agency (FSA)

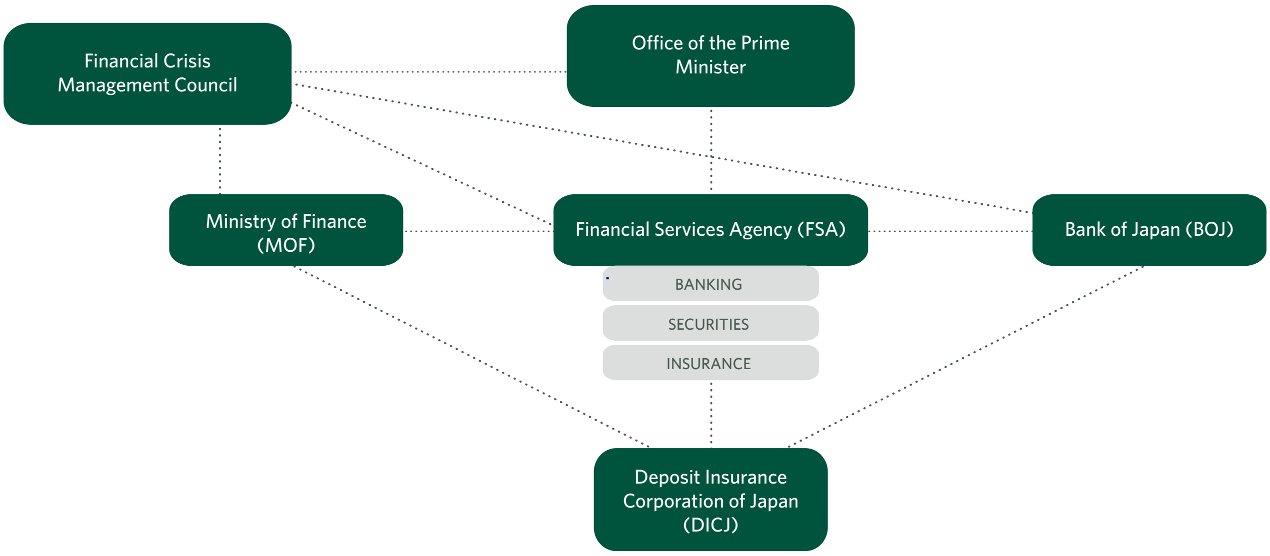
The FSA is part of the Cabinet Office. The FSA is responsible for ensuring stability of the financial system; protection of depositors, insurance policyholders, and securities investors; and smooth finance, through such measures as planning and policymaking concerning the financial system; and inspection and supervision of private sector financial institutions.

The FSA is headed by a commissioner appointed by the Minister for Financial Services based on approval of the Cabinet. The Minister for Financial Services, the Senior Vice-Minister, and the Parliamentary Secretary, who are appointed by the Prime Minister, are assigned to oversee the FSA's operations. Approximately 1,300 people are employed by the FSA.

Securities and Exchange Surveillance Commission (SESC)

The SESC is a commission under the FSA and conducts market surveillance and on-site inspections of securities companies. The SESC is authorized to carry out

FIGURE 10. The Financial Services System Regulatory Structure, Japan



Note: Dotted lines indicate a cooperative relationship.

inspections but not to take administrative actions such as penalties. The FSA imposes penalties based on the advice of the SESC. The FSA has the authority to supervise securities companies while the SESC has the authority to inspect them. The SESC is governed by a chairman and two commissioners, who are appointed to a three-year term by the Prime Minister, with the consent of both Houses. As of 2007, the SESC had a staff of approximately 600. All SESC operations are funded within the budget allocated to the FSA.

Deposit Insurance Corporation of Japan (DICJ)

The DICJ is a quasi-autonomous governmental organization established in 1971 for the purpose of operating the deposit insurance system. It consists of one Governor, four Deputy Governors, and an Auditor (part-time). Officers are appointed by the Prime Minister with the consent of both Houses of the Diet. The Policy Board within the DICJ is composed of not more than eight members, in addition to the Governor and the Deputy Governors of the DICJ. Subject to the approval of the Prime Minister and the Minister of Finance, the Governor of the DICJ appoints members to the Policy Board to a one-year term, and they can be reappointed. The executives of the DICJ, who serve a two-year term, include one Governor, no more than four Deputy Governors, and one Auditor, who are appointed by the Prime Minister subject to the approval of both Houses of the Diet. As of 2007, the DICJ had a staff of approximately 360.

The DICJ may provide for the payment of deposit insurance claims for the principal amount of ¥10 million per depositor other than deposits for payment and settlement purposes, which are protected in full. The DICJ's wholly owned subsidiary, the Resolution and Collection Corporation, handles management and disposal of assets purchased from failed financial institutions.

Figure 10 provides a graphic depiction of the relationship among the above-mentioned institutions.

Enforcement

In 1998, "Prompt Corrective Action" (PCA), a framework that provides for the FSA to issue administrative orders to financial institutions based on capital adequacy requirements, was introduced. In addition to the PCA, FSA has an "Early Warning System," including in-depth interviews, requests for reports, and administrative orders to improve a financial institution's handing of credit risk, market risk, and liquidity risk. FSA also has a PCA and an Early Warning System for securities and insurance activities.

The FSA can take various actions when faced with an institution in trouble. It can issue administrative orders requiring various measures including: alterations to a firm's business plan; a reduction in assets, a prohibition against entering into new business; a halt to deposits; an increase in capital; and the merger or closure of an institution.

Framework for Domestic Coordination

Japan has a specific crisis management mechanism—the Financial System Management Council (FSMC)[12]—that is triggered when government intervention in a troubled financial institution is necessary. The FSMC consists of the Prime Minister

[12] See Deposit Insurance Law, Article 102.

(chair), the Chief Cabinet Secretary, the Minister for Financial Services, the Minister of Finance, the Commissioner of Financial Services, and the Governor of the BOJ. The body meets when convened by the Prime Minister, to take decisions when a financial institution or institutions face serious liquidity or solvency issues. If necessary, the BOJ could provide uncollateralized loans to an insolvent financial institution upon request of the Prime Minister and the Minister of Finance, via a decision of the FSMC. Since its creation, the FSMC has been used only twice, and since the blanket guarantee was lifted, the general bank resolution measure of providing partial depositor protection has never been applied.

There is currently no explicit Memorandum of Understanding among authorities.

Finally, general advice regarding the financial system is provided via the Financial System Council, which conducts wide-ranging deliberations on the financial system in response to requests from the Prime Minister, the Commissioner of the FSA, or the Minister of Finance. The Council has conducted deliberations on matters that call for improvements of the financial system involving legislative measures, and has presented reports on the financial system from medium- and long-term perspectives.

International Coordination

Japan participates in various international organizations. Please refer to the chart of international coordination activities and organizational participation on page 234.

Current Issues

No current issues were noted.

ACRONYMS AND ABBREVIATIONS

BOJ	Bank of Japan
DICJ	Deposit Insurance Corporation of Japan
FIEL	Instruments and Exchange Law
FRC	Financial Reconstruction Commission
FSA1	Financial Supervisory Agency (1998–2000)
FSA	Financial Services Agency (2000–present)
FSMC	Financial System Management Council
MOF	Ministry of Finance
PCA	Prompt and corrective action
SESC	Securities and Exchange Surveillance Commission
¥	Yen

QATAR

Market Description

Current Qatar gross domestic product (GDP) is approximately US$60 billion. GDP grew by 10 percent in 2006 and is estimated to grow 12 percent a year through 2012. The country's per capita GDP is over US$70,000, placing Qatar among the wealthiest countries in the world. Oil and gas account for more than 60 percent of GDP, which is roughly 85 percent of export earnings and 70 percent of government revenues.[1]

Qatar has approximately 26 banks, insurance firms, and brokerage houses. There are 17 commercial banks, including 9 Qatari banks (6 commercial and 3 Islamic banks), and 7 subsidiaries of foreign banks. The three largest banks, Qatar National Bank, the Commercial Bank of Qatar, and Doha Bank, accounted for 70 percent of the market share by the end of 2006.[2] There are 9 insurance companies, 5 of which are national, and 4 of which are agencies or branches of foreign companies.[3] The local exchange, the Doha Securities Market, had 40 listed companies as of 2007.

Background

The Qatari financial regulatory system is undergoing a rapid evolution into a single integrated regulator. These changes were triggered after a government-led analysis of the existing structure indicated the need for modernization of the supervisory system. Authorities decided to adopt an onshore parallel system of financial supervision, with the Qatar Central Bank (QCB) retaining supervisory powers over existing banking institutions, and an integrated regulator, the Qatar Financial Centre Regulatory Authority (QFCRA), tasked with overseeing supervision and regulation of firms operating in the Qatar Financial Centre. The parallel system was created in response to a perceived need to attract new financial institutions into the country and to create a legal and supervisory structure that would achieve that goal. After reviewing the success of the QFCRA, the Qatari government decided to move to a single, integrated regulator.

There is also an ongoing consolidation in the securities market. In 2005, the Qatar Financial Markets Authority (QFMA) was created to supervise the Doha Securities Market (created in 1995). The QFMA is expected to merge with the QFCRA within the framework of the new single regulator.

The Qatari legal system is a historically complex hybrid of English common law (drawn from Sudan, at the time a British protectorate), Napoleonic Code (via Egypt), and civil law. Upon becoming independent in 1971, Qatar established the Qatar Monetary Agency (QMA) to maintain currency stability (pegging the Qatari Riyal to the U.S. dollar). In 1993, the Qatar Central Bank (QCB) was established and functions as the central bank, replacing the QMA.

Notwithstanding the aforementioned changes, the Qatari financial services regulatory environment was unable to keep up with the demands of a fast-growing economy. By 2004, its legal and regulatory structure was perceived as having become out-of-date. At that time, the QCB exercised limited banking supervision over approximately 20 institutions (15 banks and second-tier financial institutions). The

---

1 International Monetary Fund Country Report No. 08/5, January 2008.

2 Rankings and Market Share of all Qatar banks, www.qcb.gov.qa/Publications.

3 Ministry of Foreign Affairs, Qatar, www.english.mofa.gov.qa.

QCB required banks to have high levels of capital, and prohibited high-risk business activities. Insurance was essentially unregulated (and outside of the QFCRA regime, still is), with licenses being granted by Authorities. There has been no specific prudential regime for such domestic insurers. The powers of the QCB were enhanced in 2006, when it was granted additional prudential supervisory powers, licensing, and enforcement mechanisms for existing banks.[4]

Despite rapid economic growth, international banks and financial firms appeared to avoid Qatar for a number of reasons, including an unclear regulatory framework, an inability to secure banking licenses, a lack of legal certainty, and concerns related to the quality of the judicial system. In 2005, the Qatar government sought to modernize its regulatory infrastructure in line with the best international practices. The government created a supervisory system that would allow existing banks to remain under the supervision of the QCB, while allowing new entrants the option of supervision as part of a new Qatar Financial Centre (QFC), with its own legal, regulatory, and supervisory system. To date, over 80 firms have been licensed by the QFCRA, with approximately 60 percent of firms being licensed to undertake financial services activities, and the balance licensed to conduct related ancillary services (such as providing legal, auditing, or compliance services). This "one country-two systems" model sought not to disturb the existing regulatory arrangements and to provide a familiar supervisory and regulatory framework for existing banks while encouraging competition by offering supervision of an international standard desired by new entrants.

Banks and financial firms could choose the system under which they would be regulated. The system was expected to be observed and reviewed during its initial years of operation. The creation of a parallel system was not only a supervisory change, but also a regulatory and legal change, with new laws being adopted by the government creating the QFCRA, based on international best practices. If there were any conflicts with local Qatari law, the laws, rules, and regulations of the QFC would prevail in respect of the institutions licensed by the QFCRA.

Statutory Framework

In 1993, Amiri Decree No. 15 (amended in 1997) established the Qatar Central Bank (QCB) as the monetary authority in the State of Qatar. The QCB was mandated to formulate monetary, banking, and credit policies to achieve certain financial and economic objectives. The powers of the QCB were enhanced in 2006, when it took on prudential regulation powers, licensing, and enforcement mechanisms.

Law No. 7 of 2005 established the Qatar Financial Centre (QFC), consisting of the QFC Authority, the QFCRA, the QFC Appeals Body (renamed the QFC Regulatory Tribunal in 2007), the QFC Tribunal (renamed the QFC Civil and Commercial Court in 2007), and the QFC Companies Registration Office. The Doha Securities Market is governed by Law No. 14, effective in 1997. QFMA was established under Law No. 33 in 2005 as amended by Decree Law No. 14 in 2007 as an independent and empowered regulatory authority for the

[4] History of the Qatar Central Bank, www.qcb.gov.qa/Historical%20Perspective.asp.

domestic capital market. Its primary mission is to implement a modern and robust regulatory framework for the securities markets and conduct effective and responsible market oversight and supervision.

Nonstatutory Elements

No nonstatutory elements have been noted.

Institutional Structure of the Regulators

The Qatari regulatory system is moving toward an integrated structure.

Qatari Council of Ministers

The Qatari Council of Ministers is the highest executive authority in the country. All the laws must be approved by the Emir before they enter into force. The Emir, who is the Head of State, holds legislative power and issues the laws, proposed by the Council of Ministers, after consulting with the Advisory Council. The latter consists of five permanent committees, including one on Financial and Economic Affairs.

Qatar Central Bank (QCB)

The QCB is responsible for prudential regulation, licensing, and banking supervision. Its supervisory role will be replaced by that of the new integrated regulator, currently being referred to as the Financial Regulatory Authority (FRA). The QCB will remain in charge of monetary policy and issues related to financial stability, such as evaluation of new financial products. The QCB is governed by a Board of Directors and a Governor.

The original capital of the bank was 50 million Qatari Riyals, fully paid by the government. The capital has been increased as needed on recommendation of the QCB board and the approval of the Council of Ministers. It now holds over US$5.48 billion in assets, based on net international reserves.[5]

Qatar Financial Centre Authority (QFC)

The QFC was established in 2005 and consists of the QFC Authority, the QFC Regulatory Authority (QFCRA), the QFC Civil and Commercial Court, the QFC Regulatory Tribunal, and the QFC Companies Registration Office (CRO). It provides a distinct business legal system with administration and dispute resolution procedures. The QFC is led by a commercial authority and a regulator—the QFC Authority and the QFC Regulatory Authority, respectively—which are independent of each other.

The Chairman of the QFC Authority, in his capacity as Minister of Economy and Commerce, determines the regulations that are applicable in the QFC. Regulations affecting the duties, functions, and powers of the regulatory bodies (including the Tribunal and Court) must be consented to by the Qatari Council of Ministers.

Qatar Financial Centre Regulatory Authority (QFCRA)

The QFCRA is an integrated regulator and provides the model for the new integrated regulator (the FRA) announced in 2007. It has been closely modeled on the UK's Financial Services Authority. The QFCRA is in charge of licensing and supervision of all forms of financial services (banking, insurance, asset management, financial advisory services, securities, and derivatives dealing). The QFCRA's main objectives are financial stability and reduction of systemic risk, and promoting efficiency,

[5] uk.reuters.com/article/marketsNewsUS/idUKL1959707220071120.

transparency, integrity, and confidence in the financial market.

The QFCRA is an independent body, governed by a Board, is composed of up to six members (including a majority of international non-Qatari supervisory experts). The Board is appointed by the Qatar Council of Ministers and reports directly to the Council.

The QFRCA is financed in large part by appropriations from the Government of Qatar, supplemented by fees paid by the regulated entities. In 2006, the total expenses of the QFCRA were US$14.167 million.[6]

Other judicial and regulatory functions are carried out by the QFC Civil and Commercial Court (formerly the QFC Tribunal), the QFC Regulatory Tribunal (formerly the Appeals Body), and the QFC Companies Registration Office.

Qatar Financial Markets Authority (QFMA)

The QFMA was established in 2005 as the regulatory supervising authority of the domestic capital markets. It is the listing and licensing authority for the securities industry and relevant activities. It also has the responsibility to ensure market integrity and transparency by enforcing the market rules and regulations on market participants, and conducting the necessary surveillance and supervision activities. The QFMA has begun to implement a new regulatory infrastructure for the capital markets and the securities industry based on the International Organization of Securities Commissions requirements and recommendations.

The objectives of the QFMA include developing an adequate market structure and regulation to ensure fostering investor confidence, creation and strengthening the market institutions, conducting proper market surveillance and formulating an adequate supervision framework, streamlining market processes and reducing financial risks, and improving investor awareness and protection.[7]

The Minister of Economy and Commerce is currently the Chairman of QFMA's Board, and the Deputy Governor of the QCB serves as the Deputy Chairman of the QFMA. The activities of QFMA will be subsumed into the FRA when that body becomes active.

Doha Securities Market (DSM)

The DSM is responsible for the regulation and supervision of the issuance of and dealing in securities for purchase and sale. The DSM is considered an independent legal entity. It is managed by the Market Committee, which consists of two representatives of the Ministry of Economy and Commerce (one who is the President), the Director of the DSM, a representative of the QCB, a representative of the Qatar Chamber of Commerce and Industry, two securities brokers, two representatives of the Qatari joint-stock companies, and two experienced and qualified persons, each for a three-year term. It is expected that this oversight structure will also be overhauled at the time the FRA takes on its full responsibilities.

Financial Regulatory Authority (FRA) (future structure)

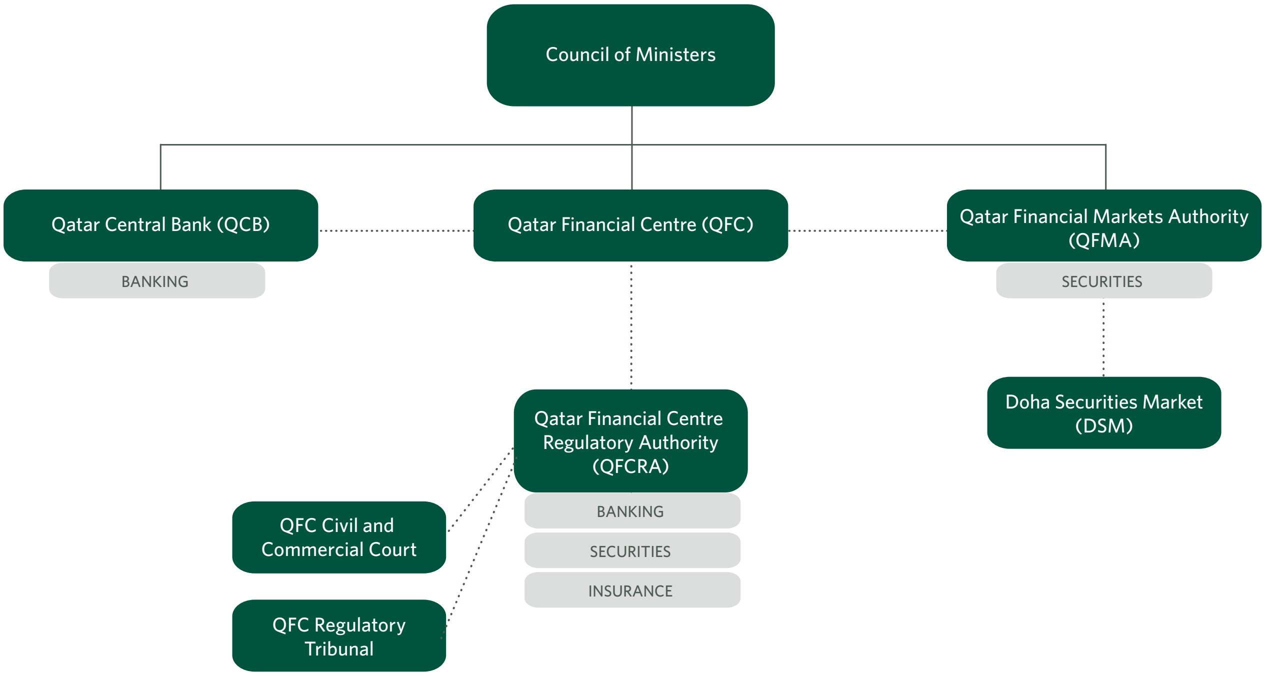
Positive feedback from market participants and an improved financial services regulatory environment prompted the Qatari

---

[6] QFCRA Annual Report 2006; www.qfcra.com.

[7] www.complinet.com/gccsummit/sponsors/about.html.

FIGURE 11. The Financial Services System Regulatory Structure, Qatar



Note: Dotted lines indicate a cooperative relationship.

government to propose to move the entire system toward a single integrated regulator (based closely on the United Kingdom [UK] model) ahead of expectations, with an initial announcement of the government's intentions in July 2007.

The unified independent financial regulatory body, known at present as the FRA, will bring together the QFCRA, the QCB's banking supervision department, and the Qatar Financial Markets Authority (QFMA). It will have broad powers to authorize, supervise, and discipline financial market participants.

Figure 11 provides a graphic depiction of the relationship among the above-mentioned institutions.

Enforcement

The QFCRA, and in due course the FRA, can take enforcement or disciplinary action for noncompliance with applicable laws and rules. The powers of the other legacy regulatory bodies are relatively limited.

Framework for Domestic Coordination

The reorganized structure of the Qatari regulatory system will ensure coordination is inherent in its design. Supervisory roles will be defined and will continue to be monitored over time.

International Coordination

Coordination within the region remains rather weak. Debate continues over the necessity of sharing supervisory responsibilities in normal periods and during periods of financial volatility. Qatar is publicly committed to joining the Gulf Cooperation Council monetary union by 2010.

Please refer to the chart of international coordination activities and organizational participation on page 234 to understand Qatar's participation in international regulatory activities.

Current Issues

The Ministry of Finance, the QCB, and the QFCRA are studying current developments in the UK and, specifically, the UK's reform of their existing tripartite arrangement among the government, the FSA, and the Bank of England, in light of the issues raised by the failure of Northern Rock. The Qatari government, the QCB, and the QFCRA (in anticipation of the FRA) are in the process of drafting a Memorandum of Understanding, outlining the respective roles of these parties upon the creation of the FRA. The Ministry of Finance will likely have the key role of the lender of last resort in the tripartite structure.

To promote deeper cooperation and coordination among the agencies, cross-membership of boards of the FRA and the QCB is being considered. Mechanisms for coordination among less senior staff are also being addressed.

The government seeks to attract international financial services firms to Qatar as competition is growing from other Middle East and North African regional financial centers. Human resources recruitment and retaining of staff is a constant task, since obtaining adequate numbers and quality of personnel resources can be problematic in the region.

A deposit guarantee insurance scheme is being considered but is not yet in place.

ACRONYMS AND ABBREVIATIONS

DSM	Doha Securities Market
FRA	Financial Regulatory Authority
GDP	Gross domestic product
QCB	Qatar Central Bank
QFC	Qatar Financial Centre
QFCRA	Qatar Financial Centre Regulatory Authority
QFMA	Qatar Financial Markets Authority
QMA	Qatar Monetary Agency
UK	United Kingdom

SINGAPORE

Market Description

The Singapore financial services sector constitutes 11 percent[1] of Singapore's gross domestic product, which, in 2006, was S$132.16 billion (Singaporean dollars).[2] The Singapore market is heavily influenced by foreign investment. There are 113 commercial banks including six local banks, 107 foreign banks,[3] and 49 merchant banks in the regulated financial services market. There are 285 entities in the capital markets sector, consisting of fund management firms, stockbrokerages, financial advisers, and futures brokers. The insurance sector comprises 217 insurance companies and brokers. The remainder of the market comprises finance companies and trust companies.

Background

Singapore has been a republic since 1965. Prior to that time, it was a Crown Colony of Great Britain. In 1959, Singapore attained self-government rule. In 1963, it joined with Malaya to form the Federation of Malaysia, but withdrew from the Federation in 1965, at which time it proclaimed itself a republic.

Singapore has an integrated financial regulatory structure, under which the Monetary Authority of Singapore (MAS) has the authority to regulate the banking, securities, futures, and insurance industries in the nation-state. The MAS is Singapore's central bank, created by an Act of Parliament in 1970. Before the establishment of the MAS, monetary functions were performed by various government departments and agencies. However, the demands of an increasingly complex banking and monetary environment necessitated streamlining functions to facilitate the development of a more dynamic and coherent policy on monetary matters.

In 1977, in a continuing effort to streamline the various financial sectors, the government decided to bring the regulation of the insurance industry under the control of the MAS. The regulatory functions under the *Securities Industry Act*, which was enacted in 1973, were also transferred to the MAS in 1984. In 1986, the *Futures Trading Act* was implemented, and is administered by the MAS.

In 2002, Singapore's Board of Commissioners of Currency merged with the MAS to rationalize common functions and realize efficiency gains, transforming the MAS into a central bank.

Statutory Framework

The *Monetary Authority of Singapore Act* (1970) defined the functions of the MAS, which are to: (a) act as the central bank of Singapore, which includes the conduct of monetary policy, the issuance of currency, the oversight of payment systems, and to serve as banker to, and financial agent of, the government; (b) conduct integrated supervision of financial services and financial stability surveillance; (c) manage the official foreign reserves of Singapore; and (d) develop Singapore as an international financial center.

Amendments to the Act in 2007 addressed, among other issues, the following:

---

1 http://financeconnectsingapore.com/financesector.php?PHPSESSID=76893c9ddb46dbc977f2f6d11cf3819.

2 http://ddp-ext.worldbank.org/ext/ddpreports/ViewSharedReport?&CF=1&REPORT_ID=9147&REQUEST_TYPE=VIEWADVANCED&HF=N&WSP=N.

3 www.mas.gov.sg/fi_directory/index.html.

- Improvement of accountability and governance of the MAS through clarification of its role as an integrated financial services supervisor and central bank managing Singapore's official foreign reserves;
- Revision of the scope of the MAS's powers to address emerging issues; and
- Consolidating requirements previously imposed under various Acts on money laundering and terrorism financing and enabling the MAS to issue regulations or directions for that purpose.

The 2007 amendments to the *Banking Act of 1970* affected policies and measures to strengthen prudential safeguards, facilitate risk-based supervision, and provide banks with greater operational flexibility. Some key changes were strengthening prudential safeguards; enhancing the MAS's role in bank resolutions; and the extension of the MAS's regulatory scope to all credit card issuers targeting the Singapore market, not just banks and financial institutions.

The *Securities and Futures Act* (2001) created the existing framework for authorization of markets and licensing of intermediaries, the scope of regulated activities, and an enforcement mechanism to enable MAS to carry out its enforcement function more efficiently.

The *Financial Advisers Act* (2001) regulates financial advisory activities in respect to investment products, and the distribution or marketing of specific functionally similar investment products, namely life insurance policies and collective investment schemes.[4] The Act consolidated previous legislation governing financial advisory services in respect to securities, futures, and life insurance products.

The *Deposit Insurance Act* (2005) requires all full banks[5] and finance companies in Singapore to be members of the Deposit Insurance Scheme. In the event a member fails, the MAS may compensate insured depositors out of the Deposit Insurance Fund built up from premiums paid by scheme members, and notify the Singapore Deposit Insurance Corporation (SDIC), which is responsible for making the payout.

The *Insurance Act* (1967) provides the regulatory framework for engaging in the insurance business and for acting as insurance intermediaries in Singapore. As part of an ongoing effort to bring the regulatory framework for the insurance sector up to international best practice standards, the Act was amended in 2003 to provide for a risk-based capital framework for life and non-life insurance companies.

The *Trust Companies Act*, which was substantially amended and reauthorized in 2005, requires the mandatory licensing of trust companies. Prior to reauthorization, trust companies were regulated by the Accounting & Corporate Regulatory Authority, and registration of trust companies was voluntary. The framework for the regulation of trust companies set out in the Act also makes provision for the MAS to issue notices to counter money laundering and financing of terrorism.

---

[4] Collective investment schemes are similar to mutual funds. A collective investment scheme is an arrangement where money from investors is pooled together. The scheme may invest in various types of assets such as financial, real estate, precious metals, or commodities.

[5] Full banks refer to banks holding a license granted by the MAS under the Banking Act (Cap. 19), which permits the bank to conduct the full range of banking business.

The *Accounting Standards Act* (ASA) was enacted in 2007. With the coming into force of the ASA, the Accounting Standards Council (ASC) assumed the task of prescribing accounting standards from the Council on Corporate Disclosure and Governance. MAS and the Singapore Exchange Limited (SGX) have taken over the purview of disclosure practices and the corporate governance framework of listed companies.

Nonstatutory Elements

Association of Banks in Singapore (ABS)

Created in 1973, the ABS's role is to represent and further the interest of its members, set standards of good practice, and upgrade their expertise. It aims to achieve this through regular dialogue and consultation with the MAS to discuss industry issues and promote a sound financial system in Singapore.

Investment Management Association of Singapore

The Association was formed in 1997 and is a representative body of investment managers spearheading the development and growth of the industry in Singapore. By establishing high standards and industry practices among members, the association seeks to set the benchmark for the investment and fund management industry in Singapore. It also serves as a forum for member discussions, and as a collective voice where representation is needed on behalf of the investment management industry.

Singapore Exchange Limited (SGX)

SGX was inaugurated in December 1999, following the merger of two financial institutions, the Stock Exchange of Singapore and the Singapore International Monetary Exchange. The Risk Management and Regulation division of SGX addresses issuer regulation, member supervision, market surveillance, enforcement, risk management, and regulatory policy.

As in all other developed economies, there are numerous industry associations within the financial services sector. These include the Securities Association of Singapore, the Life Insurance Association, the Singapore Reinsurers Association, and the General Insurance Association of Singapore.

Institutional Framework

Singapore has an integrated financial regulatory structure, under which the MAS has the authority to regulate the banking, securities, futures, and insurance industries in Singapore.

Ministry of Finance (MOF)

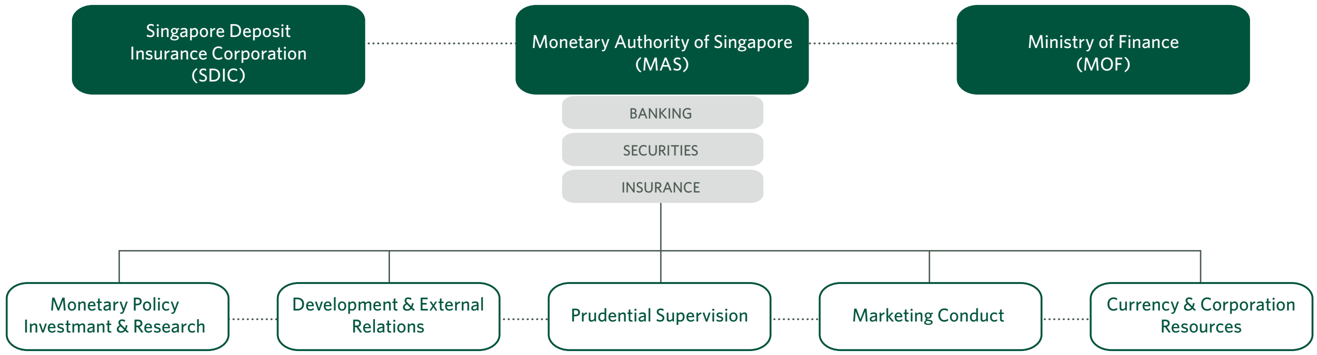
The emphasis of the MOF's regulatory policy is on economic development; the ministry does not have a role as a financial supervisor. The MOF actively reviews its rules to ensure they remain relevant to the business and financial environment. This is done in close consultation with industry experts and key stakeholders.

Monetary Authority of Singapore (MAS)

The MAS, as Singapore's central bank, is authorized to act as a banker to, and financial agent of, the government. It has a responsibility to promote monetary stability and credit and exchange policies conducive to the growth of the economy.

As the integrated supervisor of the financial services sector, the MAS conducts risk-based supervision of financial institutions. This includes authorization or licensing of financial institutions to offer financial services, setting regulatory rules and standards, and taking actions against

FIGURE 12. The Financial Services System Regulatory Structure, Singapore



Note: Dotted lines indicate a cooperative relationship.

institutions and individuals for regulatory breaches. The MAS also monitors the financial system to identify emerging trends and potential vulnerabilities in order to guide and support its regulatory activities.

The MAS has the authority to make loans and advances to any financial institution under the *Monetary Authority of Singapore Act* if it thinks this action is necessary to safeguard the stability of the financial system or public confidence in the financial system. The MAS may issue regulations and directions to financial institutions, which include all entities approved, authorized, licensed, registered, or otherwise regulated by MAS.

The MAS Board of Directors is composed of a Chairman and at least four, but no more than nine, directors. The Chairman is appointed by the President of Singapore, on the recommendation of the Cabinet. The directors are appointed by the President. No one may be appointed as a MAS director who is a director or salaried official of any financial institution licensed or approved by the MAS. A managing director, appointed by the President from one of the current directors, is responsible for the day-to-day administration of the MAS.

The Board is responsible for the policy and general administration of the affairs and business of the MAS. It informs the government of the regulatory, supervisory, and monetary policies of the MAS. The MAS has operational autonomy, although the board remains accountable to the Parliament through the minister in charge of the MAS.

The MAS receives its income from its investment activities.

Singapore Deposit Insurance Corporation (SDIC)

The SDIC, which was established in 2006, is a company limited by guarantee,[6] and is not part of the government. However, the SDIC was established by an act of Parliament and has been designated to be the Deposit Insurance Agency. The

[6] A public company limited by guarantee is one that carries out nonprofit activities that have some basis of national or public interest.

board of the SDIC is also accountable to the minister in charge of the MAS. In the event an SDIC member fails, the SDIC will make reimbursements from the annual insurance premiums members pay under the Deposit Insurance Scheme.

The annual premiums levied on member institutions are differentiated according to the risk they pose to the Fund. These risk-based premiums are charged to member institutions as a percentage of the amount of insured deposits they hold. In the event a member fails, all the eligible accounts with that member, except for deposits under the Central Provident Fund (CPF) Investment Scheme,[7] are aggregated and insured up to S$20,000, net of the liabilities to the member, such as loans. Moneys held in bank deposits under the CPF Investment Scheme (CPFIS) are separately insured up to S$20,000.[8]

The Fund invests in liquid assets such as Singapore Government Securities, deposits with the MAS, and other assets approved by the minister in charge of the MAS.

Figure 12 provides a graphic depiction of the relationship among the above-mentioned institutions.

Enforcement

Enforcement is handled by the MAS and the Police's Commercial Affairs Department. MAS's actions can include a reprimand, issuance of directions to a regulated entity, imposition of a fee on a regulated entity suspected of committing an offense, taking civil penalty action against market misconduct, referral of the matter to the Commercial Affairs Department for criminal investigations and prosecution, or in serious cases, the revocation of licenses.

Appeals can be made to the Minister in charge of the MAS against certain decisions made by the MAS.

In case of a banking failure, the MAS has the power to: (a) require the bank concerned to take immediate actions that it considers necessary; (b) appoint statutory advisers to advise the bank on proper management of the bank's business; and (c) assume control and management of the bank, or appoint statutory managers to do so.

Framework for Domestic Coordination

The MAS maintains a close relationship with the Ministry of Finance (MOF). However, MOF's role is limited with regard to the regulation of banks and financial institutions, as all supervisory powers are vested in the MAS. As an integrated regulator, many of the coordination functions needed in other systems are internal to the MAS organization. The MAS conducts stress testing to assess its ability to handle financial crises and bank failures. The MAS works with the MOF to assess the need for, and appropriateness of, measures to maintain financial stability in times of crisis.

International Coordination

The MAS maintains a close working relationship and communication with foreign regulators on supervision of both foreign and local financial institutions in Singapore. Please refer to the chart of international coordination activities and organizational participation on page 234.

Current Issues

Currently, there is no significant debate on regulatory structure.

---

7 The CPF is a comprehensive social security savings plan.

8 www.sdic.org.sg.

ACRONYMS AND ABBREVIATIONS

ABS	Association of Banks in Singapore
ASA	*Accounting Standards Act*
ASC	Accounting Standards Council
CPF	Central Provident Fund
CPFIS	Central Provident Fund Investment Scheme
MAS	Monetary Authority of Singapore
MOF	Ministry of Finance
SDIC	Singapore Deposit Insurance Corporation
SGX	Singapore Exchange Limited

SWITZERLAND

Market Description

The Swiss financial markets sector is one of the largest sectors in the national economy. Banks, insurance companies, securities firms, and other financial intermediaries account for approximately 12 percent of the country's gross national product, 6 percent of employment, and 10 percent of the tax basis in the country.[1] The Swiss market is dominated by two large banks, UBS AG and Credit Suisse Group, which account for more than one-third of the domestic financial services market. There are 24 Cantonal banks[2] in the Swiss Confederation, which, with 76 of the regional banks, account for almost another third of the number of banks operating in Switzerland.

Swiss banks are predominantly universal banks, that is, they offer deposit taking (which defines them as a bank), lending, securities, and insurance services to the public.

Background

The Swiss regulatory system is moving from a functional toward an integrated regulatory structure. In January 2009, the Swiss Federal Banking Commission (SFBC), the Federal Office of Private Insurance (FOPI), and the Anti-Money Laundering Control Authority will be merged into the Federal Financial Markets Supervisory Authority (FINMA). The merger is required by the *Act Concerning Swiss Financial Markets Supervision* (FMSA), which establishes FINMA as a federal authority.

Switzerland is not a member of the European Union (EU); however, it has adopted many EU Directives to ensure Swiss banks a level playing field with their mainly European competitors.

Banking supervision was introduced in Switzerland by the *Federal Act on Banks and Savings Institutions* of 1934 in response to the banking crisis of the 1930s. The Act established the SFBC as the regulatory body for banking organizations. The Swiss definition of banking is the public announcement to accept deposits, which, according to Swiss law, only a bank may do. Some activities warranting a banking license in other countries, such as equity-financed lending, foreign currency exchange, or (until 1998, see securities section) brokering, could be performed without a banking license in Switzerland.

Provisions for federal supervision of insurance activities were included in the Federal Constitution of 1874; however, the FOPI was not created until 1885. In 2006, the revised *Insurance Supervision Act* was adopted, to secure the long-term stability of the insurance companies and to improve the protection of insured parties.

Statutory Framework

The 1934 *Federal Act on Banks and Savings Institutions* (BA) defined regulated banking activities and established requirements pertaining to capital adequacy and liquidity, accounting, and audit. It established the SFBC as the supervisory authority and delineated its authority over the proceedings for the restructuring and bankruptcy of banks. It defined several crimes, including the violation of bank secrecy.

The 1995 *Stock Exchanges and Securities Traders Act* (SESTA) provisions are further delineated by a 1996 ordinance of the Federal Council.[3] The *Investment Funds Act* (IFA) of 1966 was amended in 1994 to allow the creation of investment

---

1 Federal Department of Finance, "Figures on Switzerland as a Location for Financial Services," 2008.

2 Cantonal banks are semi-government owned, as a portion of the capital is held by the Cantons of Switzerland.

3 The Swiss Federal Council is a seven-member executive council that serves as the collective head of state.

funds in Switzerland, which comply with the requirements of the EU Directive, *Undertakings for the Common Investment in Transferable Securities*. In 2006, the *Collective Investment Schemes Act* replaced the IFA. The new act expands the number of legal forms in which a collective investment can be undertaken and removes some restrictions for qualified investors.

The 2006 *Insurance Supervision Act* (ISA) is the legal foundation for supervision of conglomerates, expanding supervisory responsibilities in the areas of corporate governance, transparency, and consumer protection. In particular, the disclosure requirements of insurers have been increased considerably. Reinsurers are subject to the same solvency supervision as direct insurers.

The FMSA will be fully implemented in 2009, and provides the underpinning for the integrated regulatory structure. Some of its provisions have already been implemented to allow for the organizational structure of FINMA to be built to ensure a smooth transition from the former regulatory structure. The FMSA will not replace the current legislation for the individual financial sectors. The BA, ISA, and SESTA, including all regulations issued interpreting these Acts, will remain in force. Only the parts relating to the supervisory authorities, their duties, and their organization will be replaced by the FMSA.

Nonstatutory Elements

The SFBC recognizes some aspects of self-regulation as a minimum standard, as established by a professional organization (such as the Swiss Bankers Association or the Swiss Funds Association). As a result of this recognition, the minimum standards no longer apply only to the members of the respective self-regulatory organization, but must be respected as the minimum standard by all industry participants.

The mandate of the Swiss Bankers Association is to maintain and promote the Swiss financial services industry. The Association works with the regulatory agencies to develop further self-regulation arrangements within the industry.

Institutional Structure of the Regulators

The regulatory system in Switzerland is moving from a functional toward an integrated structure.

Swiss National Bank (SNB)

The SNB, founded in 1906, conducts the country's monetary policy as an independent central bank. In addition, the SNB contributes to financial stability by regularly analyzing and monitoring conditions and developments in the financial system. It oversees the systemically important payment and securities settlement systems and contributes to the regulatory framework of the financial sector. The SNB is also the lender of last resort. It is governed by an 11-member Bank Council, a Governing Board, and an Audit Board, and has approximately 675 employees.

Swiss Federal Banking Commission (SFBC)

The SFBC is an independent agency and not part of the central government. Administratively, however, it is integrated within the Federal Department of Finance. The SFBC is the supervisory authority of both institutions and markets. It focuses on the maintenance of liquidity and solvency of a particular institution, the transparency of ownership of listed companies and market activities, and the protection of minority shareholders.

Swiss banking supervision is based on a division of tasks between the SFBC and a number of audit firms that are specially authorized for supervisory tasks. The authorized audit firms conduct on-site audits, while the SFBC retains responsibility for overall supervision and enforcement measures. The auditors act, in some sense, as an extension of the SFBC, exercising direct supervision through regular audit checks of their clients. They must report immediately to or notify the SFBC of the results of their audits if significant findings have been made. All costs of the audits are assumed by the institutions being audited. Also, to ensure the robustness of the supervisory system, it carries out quality control checks on the authorized audit firms and, on occasion, may directly monitor their audit procedures at banks or securities dealers. The SFBC was given sole responsibility for bankruptcy proceedings of banks.

The SFBC is appointed by the Federal Council after nomination by the Head of the Department of Finance. The SFBC is financed by fees and general charges levied on the institutions it supervises. It consists of seven individuals, a full-time president, and six part-time members. To fulfill its duties, the SFBC employs approximately 160 people, who make the day-to-day decisions.

The deposit protection scheme covers "privileged deposits" of up to 30,000 Swiss francs per depositor.

Federal Office of Private Insurance (FOPI)

The FOPI is a federal office under the full authority, including specific directives, of the Federal Department of Finance. It has divisions responsible for non-life insurance, intermediary supervision, life insurance, group supervision, health insurance, and reinsurance.

The members and the Director of the FOPI are appointed by the Federal Council upon nomination by the Head of the Department of Finance. The FOPI has approximately 90 staff members.[4] It is financed by the institutions it supervises through the levy of fees and general charges, which depend at least partially on the size of the supervised institution.

Federal Financial Markets Supervisory Authority (FINMA) (future structure)

Within the future structure, FINMA will be the integrated regulator and will assume the responsibilities of the SFBC and the FOPI, and responsibility for anti-money laundering oversight. FINMA will have an Administrative Board headed by a President, and an executive management headed by a Director, appointed by the Federal Council upon proposal of the Head of the Department of Finance. FINMA will report annually to the Federal Council to discuss strategy matters and current issues. In 2008, the Federal Council appointed seven of the future nine members of FINMA's Administrative Board. Six are members of the SFBC, including its current president, who was also appointed president of the Board, and a former Chief Risk Officer of a major reinsurance company. FINMA will continue to be financed similarly to SFBC and FOPI, through the levy of fees and general charges.

Figure 13 provides a graphic depiction of the current financial system regulatory structure.

[4] www.bpv.admin.ch.

FIGURE 13. The Financial Services System Regulatory Structure, Switzerland

Note: Dotted lines indicate a cooperative relationship.

Enforcement

The SFBC has broad powers and can take enforcement or disciplinary action for noncompliance with applicable laws and rules. When the SFBC finds evidence that crimes have been committed, it informs the Federal Department of Finance or the responsible cantonal offices.

FINMA will also have these enforcement powers. In addition, it will have the ability to prohibit individuals from employment in the financial sector for up to five years and to confiscate profits arising from unlawful behavior.

Framework for Domestic Coordination

In 2007, the SFBC and the SNB signed a Memorandum of Understanding (MoU) regarding financial stability. The MoU defines the relationship between the two institutions and sets out the framework for strengthened cooperation in the future. The MoU includes a clear division of the individual responsibilities of the two institutions. In particular, the MoU governs the way in which information is exchanged and opinions shared, and the manner in which the two authorities cooperate in regulatory matters.

International Coordination

As a non-member of the EU, Switzerland is not subject to any formal commitments; however, as noted, it has adopted a number of EU directives. Please refer to the chart of international and European organizations for further details, on page 234.

Current Issues

The main issue under discussion is the implementation of the new regulatory framework.

ACRONYMS AND ABBREVIATIONS

BA	*Federal Act on Banks and Savings Institutions* of 1934
EU	European Union
FINMA	Federal Financial Markets Supervisory Authority
FMSA	*Act Concerning Swiss Financial Markets Supervision*
FOPI	Federal Office of Private Insurance
IFA	*Investment Funds Act*
ISA	*Insurance Supervision Act*
MoU	Memorandum of Understanding
SESTA	*Stock Exchanges and Securities Traders* Act of 1995
SFBC	Swiss Federal Banking Commission
SNB	Swiss National Bank

UNITED KINGDOM

Market Description

The Financial Services Authority (FSA) in the United Kingdom (UK) licenses and regulates around 22,350 financial services firms. An additional 5,980 financial services firms operating in the United Kingdom (UK) are licensed elsewhere in the European Economic Area.[1] Approximately 400 of these firms are banks or building societies, and almost 1,100 are insurance companies.

The financial services sector accounted for nearly 10 percent of UK gross domestic product in 2006. In individual markets, recent Bank for International Settlements survey data suggest that the UK accounts for 34 percent of global foreign exchange turnover and 43 percent of global over-the-counter derivative turnover. It also accounts for 20 percent of international bank lending, and is a major investment management center, with £3.5 trillion in assets under management in 2005.

Background

The regulatory structure in the UK is characterized as an integrated structure, but this has not always been the case. Until the late 1970s, financial regulation in the UK operated on a largely nonstatutory basis under rules that were often enshrined in contracts between firms and individuals on the one side, and trade and professional bodies on the other. In some areas, regulation was "informal" in the sense that rules were enforced by moral suasion or peer pressure. Banks operated within an extensive body of case law built up over many years, but which mainly focused on the nature and enforceability of banking contracts. In addition, provision of credit, by banks and others, was subject to various statutes principally concerned with consumer protection.

The Bank of England (BoE) exercised informal oversight of the banking sector based on its operational involvement in markets and its access to a broad range of "market intelligence." It also had a general power, under the *Bank of England Act 1946* and subject to the approval of Her Majesty's Treasury (HMT), to give "directions to bankers." This power was never used, but its existence may have helped support the informal guidance that from time to time the BoE gave to banks. Most securities business, at least until the birth of the eurobond market, took place on the London Stock Exchange, and was subject to the Exchange's nonstatutory rules. There were statutory provisions concerned with the fraudulent offering of or dealing in securities. For insurance, the main statutory requirement involved the "audit" by actuaries in a government department (later the Department of Trade and Industry) of insurance companies' reserves.

During the 1970s, a number of serious problems arose with "fringe banks," the nature of whose business made them less visible to the BoE than those involved in mainstream banking business. At the end of 1973, the BoE was called upon to orchestrate a "lifeboat" operation in conjunction with the major commercial banks to counter what was perceived as a potential threat to the stability of the banking system. Subsequently, a formal statutory regime for banking supervision (under the *Banking Act 1979*) was introduced, with the BoE taking the role of supervisor. This role was reinforced by a new *Banking Act 1987*, in the aftermath of further problems among small banks involved in property lending,

1 FSA Annual Report 2006/07.

and the regime remained in place until the major reorganization of regulation in 1997.

Problems in the retail securities sector during the early 1980s, together with the recasting of the market as a result of the 1986 "Big Bang" (which removed the previous single-capacity restrictions on securities firms in the UK), prompted an overhaul of regulation with the *Financial Services Act 1986*.

During the 1990s, it became increasingly clear that the fragmented nature of the regulatory regime in the UK, particularly in relation to securities business, was inconsistent with the way major financial firms were developing as integrated "full service" groups. This evolution of financial service firms was one of the main motives for moving to an integrated regulator in 1997.

The new Labour Government elected in 1997 had determined to give the BoE operational independence in relation to monetary policy. It also decided that assigning the further role of integrated financial regulator to the BoE, in a financial center as large as London, would involve an undue concentration of power, as the BoE was only indirectly politically accountable. This, combined with a number of additional considerations (such as potential conflicts of interest and of priorities, and the increasingly divergent staffing requirements of the monetary policy and regulatory functions) led to the conclusion that a free-standing, integrated regulator, should be established. Consequently, the Chancellor of the Exchequer announced a major reform of financial services regulation in the UK and the creation of a new regulator. In October 1997, the Securities and Investments Board was renamed the Financial Services Authority, with responsibility for banking supervision transferred to the FSA from the BoE in mid-1998. In 2000, the FSA took over the role of UK Listing Authority from the London Stock Exchange.

The new regime is based on the *Financial Services and Markets Act 2000* (FSMA), which came fully into effect at the end of 2001, when most remaining financial regulatory responsibilities were formally transferred to the FSA.[2]

Statutory Framework

The statutory framework for regulation in the UK is set out in the FSMA, which replaced a plethora of previous legislation, and set out the statutory objectives for the FSA and the principles for regulation.

The FSA undertakes both prudential and conduct-of-business regulation. It has the power to make rules to meet its statutory objectives, subject to specific and extensive requirements on consultation.[3] In many areas, the substance of the supervisory regime is determined by EU legislation, negotiations on which are the responsibility of HMT. There are also interrelationships with the competition authorities, notably the Office of Fair Trading and the Financial Ombudsman. The FSA also exercises various powers under the *Building Societies Act 1986*, the *Friendly Societies Acts 1974* and *1992*, and the *Industrial and Provident Societies Act 1965*.

[2] In 2001, the FSA took over the responsibilities of the Building Societies Commission, HMT (in respect of insurance supervision), the Friendly Societies Commission, the Investment Management Regulatory Organization, the Personal Investment Authority, the Register of Friendly Societies, and the Securities and Futures Authority. In 2004, the FSA was given responsibility for mortgage regulation, and in 2005, it was also tasked with the regulation of general insurance.

[3] www.fsa.gov.uk/Pages/About/Who/Accountability/legal/index.shtml on the legal framework.

As noted, under the *Bank of England Act 1946*, the BoE has the general power to give "directions to bankers" subject to the approval of HMT.

The conduct of takeover bids in the UK is governed by a Code,[4] which, since 1968, has been overseen by the Takeover Panel. Under the EU Directive on Takeover Bids (2004/25/EC), the Panel is designated the supervisory authority for certain regulatory functions, but the substance of the Code itself is not described in the statute.

Nonstatutory Elements

The main area of financial regulation falling outside the FSA's purview is corporate reporting and governance. This is the responsibility of the Financial Reporting Council, under which are six operational units covering accounting standards, auditing practices, actuarial standards, professional oversight of audit firms, review of financial reporting, and professional discipline in accountancy. The Council itself maintains the so-called Combined (corporate governance) Code.

Several important aspects of banking conduct are governed by the nonstatutory Banking Code, overseen by the Banking Code Standards Board, which is sponsored by the British Bankers Association, the Building Societies Association, and APACS (the UK Payments Association), but with a majority of independent directors on the 10-person board.

Institutional Structure of the Regulators

The UK structure is characterized as an integrated regulatory structure and involves the following institutions.

Her Majesty's Treasury (HMT)

The Chancellor of the Exchequer and HMT are responsible for determining the statutory framework for financial regulation. In addition, the Chancellor, as Chair of the Tripartite Committee, has a key role in decision making in times of banking failures and financial crisis management. In the case of a bank failure where public funds are to be committed, the Chancellor has the final say.

Bank of England (BoE)

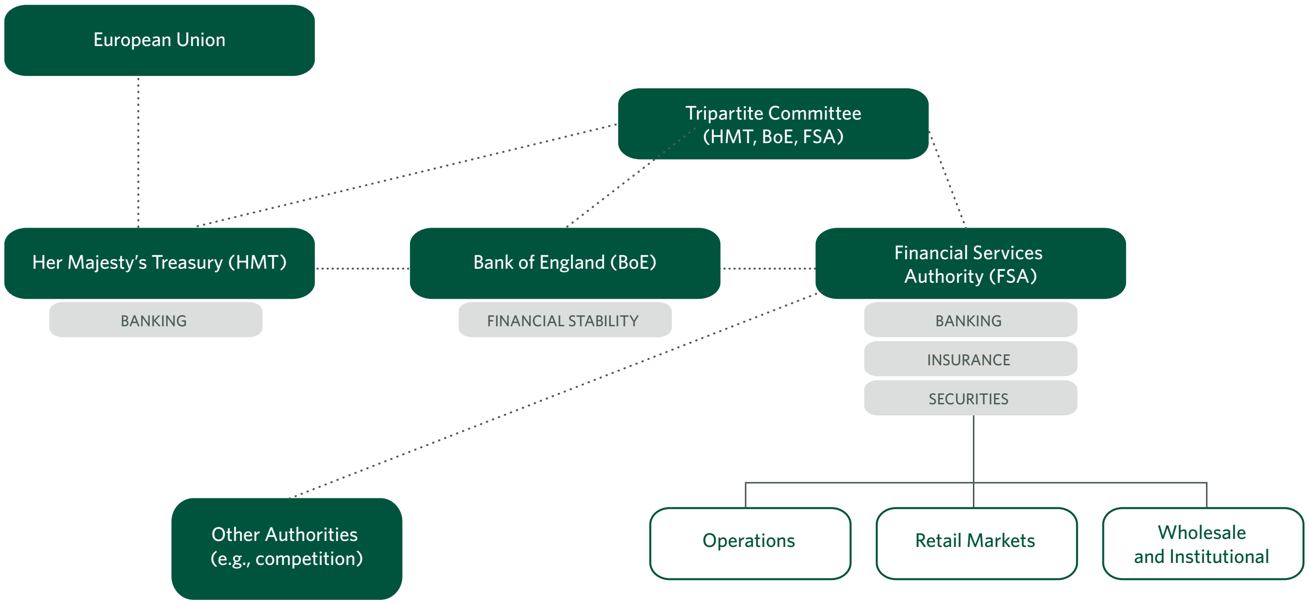
The BoE relinquished its responsibilities for banking supervision in 1997, but it retains financial stability as one of its two core purposes. It carries out this task not only through its monetary policy role, but also through its oversight of systemically important payments systems, by maintaining a broad overview of the system as a whole, and by providing liquidity to the banking system, which, in exceptional circumstances, can involve acting as lender of last resort. The government recently proposed changes to the law to formalize the BoE's financial stability role, and to give it a role in implementing the special resolution regime for failing banks, if this is triggered by the FSA.

Financial Services Authority (FSA)

The FSA was established as a private company limited by guarantee with four statutory objectives: maintaining market confidence, promoting public awareness (on financial matters), protecting consumers, and reducing financial crime. The FSA is also required to respect a set of "principles of good regulation": efficiency and economy, the role of management,

[4] www.thetakeoverpanel.org.uk/new/codesars/DATA/code.pdf.

FIGURE 14. The Financial Services System Regulatory Structure, United Kingdom



Note: Dotted lines indicate a cooperative relationship.

proportionality, innovation, the international character of financial services, and competition. Internally, the FSA is divided into three main areas, operations, retail markets, and wholesale and institutional markets, each headed by a Managing Director, plus a group of central services reporting to the Chairman or Chief Executive Officer.

The FSA operates under a Board with 14 members, all appointed by HMT. The Board is headed by a non-executive Chairman and four executive members, the Chief Executive and three Managing Directors. The remaining nine members are non-executive and include, ex officio, the Deputy Governor (Financial Stability) of the BoE. The Board has overall responsibility for running the FSA, and besides general matters of policy, is concerned especially with internal management, including issues relating to budgets and staff remuneration. The FSA is required to report to Parliament annually.[5]

The FSA employs about 2,800 staff. It is financed by fees levied on the firms supervised, receives no public funds, and borrows from the private sector if necessary via a revolving credit facility with a major UK bank. The FSA's Board oversees and approves the budget.

Figure 14 provides a graphic depiction of the relationship among the above-mentioned institutions.

[5] www.fsa.gov.uk/Pages/About/Who/Accountability/Relations/index.shtml.

Enforcement

The FSA has broad powers of investigation, enforcement, and civil and criminal prosecution. The FSMA contains provisions for a Complaints Commissioner to hear complaints against the FSA,[6] and a Financial Services and Markets Tribunal, to review disputes between the FSA and individuals or firms. The Tribunal can make binding rulings in these cases.[7] The FSA seeks to avoid duplication of enforcement actions taken by other agencies, including those responsible for law enforcement, and will generally defer to the other agencies where they have the principal statutory responsibility.

Framework for Domestic Coordination

Her Majesty's Treasury (HMT) is responsible for determining the statutory framework for financial regulation and, in relation to financial crises, deciding whether public funds should be used to mitigate its effects. The BoE, in addition to monetary policy, contributes to financial stability through its market operations, its oversight of key payments systems, and its access to market intelligence, and, in a crisis, may undertake official financial operations to limit potential market impact. The FSA regulates individual firms and markets using the FSMA, and, in a crisis, would explore the potential for private sector solutions.

The new institutional structure, introduced in 1997, was documented in a Memorandum of Understanding (MoU) among HMT, the BoE, and the FSA, setting out their respective responsibilities, and arrangements to ensure coordination of their activities.[8] One element of these arrangements was the creation of a Tripartite Standing Committee[9] comprising representatives of HMT, the BoE, and the FSA. The representatives are the Chancellor of the Exchequer, the Governor of the BoE, and the Chairman of the FSA, but in practice, the Committee has often met at the deputies level. An HMT representative chairs the Committee, which seeks to ensure timely and effective exchange of information among the three institutions.

The Tripartite Committee meets on a monthly basis to discuss individual cases of significance and other developments relevant to financial stability. Meetings may occur at other times if there appears to be an issue that needs urgent attention. Each authority has representatives who meet, at short notice, in times of crisis. In these circumstances, the BoE and the FSA are each to assess, from the perspective of their distinct responsibilities and expertise, the seriousness of the crisis and its potential implications for the stability of the financial system. Ultimate responsibility for authorization of support operations in exceptional circumstances rests with the Chancellor.

Until recently, the coordination framework established by the MoU had not been tested by a major financial crisis. Following recent events in the UK, the authorities suggested[10] changes to the framework to:

---

6 www.fsa.gov.uk/Pages/About/Who/Accountability/CC/index.shtml.

7 www.fsa.gov.uk/Pages/About/Who/Accountability/FSAMT/index.shtml.

8 www.fsa.gov.uk/pubs/mou/fsa_hmt_boe.pdf.

9 The full name of the committee is The Standing Committee on Financial Stability.

10 "Financial Stability and Depositor Protection: Strengthening the Framework," January 2008.

- Make a clearer distinction between "normal" and "crisis" arrangements;
- Improve external communications, where such communications are judged necessary;
- Ensure that the Authorities have sufficient resources available to deliver the arrangements;
- Authorize increased BoE involvement with individual firms if emergency assistance is likely to be needed; and
- Clarify responsibilities for decisions to provide support to firms, both to ensure that the terms of any emergency lending are discussed among the Authorities, and that the responsibilities for the provision of general liquidity are clarified.

International Coordination

The UK participates in both international and European financial services organizations. Please refer to the chart of international coordination activities and organizational participation on page 234, and to the European Union profile for an explanation of coordinating activities within the EU.

Current Issues

There is an active debate about how to make international cooperation in regulation more efficient and effective in the future. Some of this debate, which began before the recent disruptions in financial markets, is focused on arrangements within Europe, but for global firms the issues are broader.

Possible solutions proposed include:

- Greater international convergence of rules, most obviously in banking supervision, but also now in insurance (in the EU) and accounting standards.
- Greater reliance on a lead regulator—typically the home supervisor of the group. The issue here is that since a subsidiary has capital of its own, local supervisors are interested in the distribution of capital within the group, and in its overall adequacy. Within insurance, there are proposals to address these issues through the draft Solvency 2 directive, due to come into force in the EU in 2012. One possibility is that each subsidiary would be expected to meet the minimum capital requirement, rather than the (higher) solvency capital requirement, which would be set only on a group-wide basis. This would allow firms some benefit from the diversification of risks across a group, and may reduce the amount of subsidiary-specific review that is required.
- Related to this, the more frequent use of regulatory colleges, to share information and reduce duplication. There are practical limitations on how large such colleges can be.
- Agreement that group-wide prudential assessments or group-wide system and control reviews, need not be replicated for every subsidiary in the group.
- Attempts to bring about greater alignment of standard regulatory reporting.

Recent events have heightened concerns about the complex potential interactions in these cases among different sets of national legislation (for instance on insolvency, or deposit protection). There are also issues in the context of crisis resolution with the interaction with EU rules on state aid (and competition rules more generally); transparency (under legislation designed to combat market abuse); and the European Convention on Human Rights, to the extent that it relates to directors, creditors, and shareholders of a failing firm.

Finally, in light of recent experiences, a number of existing questions have been sharpened, and some new ones added. The issues identified for further work include:

- Liquidity, about which the FSA issued a discussion paper at the end of 2007.
- A reassessment of some of the details of the Basel II capital rules.
- Deposit protection arrangements and other means to resolve failing institutions smoothly, which were discussed in the papers from the Tripartite Authorities in January and July 2008. On deposit protection, the key issues are the level of cover, the extent to which the scheme is prefunded, and the speed with which payment is made. The papers also look at tools that might allow the Authorities more easily to achieve an orderly resolution of a failing bank.
- To reexamine the approach to valuation when markets freeze up, so that positions are evaluated on the basis of realistic and prudent assumptions.
- The appropriate level of disclosure: where there have been calls for additional transparency in areas such as structured products, but for greater discretion in areas such as emergency lending by the official sector.
- Improvements to risk management, particularly to sharpen the understanding of the "tails" of the distribution, and to take account of systemic shocks.
- Appropriateness of sales practices, both for subprime mortgages and for certain structured products.

In the UK, there has been some debate over the supervisory structure following the problems at Northern Rock, and criticism of each of the Tripartite Authorities (the FSA, the BoE, and HMT). These ideas have been fed into the review being undertaken by the Authorities, who have not proposed a major restructuring of responsibilities, but are examining ways in which it can be made to work more effectively.

As noted, there has been a more general interest in reforms to the deposit insurance scheme, and in how failing banks can be resolved more effectively and efficiently. These issues are currently under consideration by policymakers, with further consultation promised on the details.

ACRONYMS AND ABBREVIATIONS

BoE	Bank of England
EU	European Union
FSA	Financial Services Authority
FSMA	*Financial Services and Markets Act 2000*
HMT	Her Majesty's Treasury
£	British pound sterling
MoU	Memorandum of Understanding
UK	United Kingdom

THE TWIN PEAKS APPROACH

The twin peaks approach, a form of regulation by objective, is one in which there is a separation of regulatory functions between two regulators: one that performs the safety and soundness supervision function and the other that focuses on conduct-of-business regulation.

Australia · The Netherlands

AUSTRALIA

Market Description

Banking services in Australia are provided by Authorized Deposit-Taking Institutions (ADIs), which include banks, building societies, and credit unions. As of September 2007, there were 58 banks, including 14 domestic banks, 10 locally incorporated foreign banks, and 34 foreign bank branches.[1] Four banks (the "Big Four") dominate the local market: the Australia and New Zealand Banking Group Limited, Commonwealth Bank of Australia, the National Australia Bank Limited, and Westpac Banking Corporation. These banks control around 67 percent of total domestic banking assets.

Following reforms introduced in 1992, there have been no restrictions on the number of foreign banks operating in Australia. Foreign financial companies are substantial competitors in investment banking and securities and brokerage, and foreign banks represent 11 percent of domestic credit.

The remainder of the ADI sector is made up of building societies and credit unions, which specialize in providing personal finance for residential and other domestic purposes. As of September 2007, there were 132 credit unions and 12 building societies. Insurance services are provided by direct insurers and reinsurance firms with about A$90 billion in assets.

Superannuation (pensions) has been the fastest-growing sector of the financial services industry in Australia, with assets accounting for over a quarter of the total assets of the financial system.[2]

In 2006/07, the financial services industry accounted for 7.3 percent of Australia's gross domestic product.[3]

Background

The current Australian structure can be described as a twin peaks system, and is the result of a specific series of reforms that took place in the late 1990s. In the early 1980s, Australia deregulated its financial services in response to the perception that the existing financial system had outdated regulatory structures.[4] In 1997, the Wallis Committee was charged with looking at the results of deregulation since the early 1980s, with a focus on realigning and streamlining regulation to make it more efficient and effective.[5]

Following a review of the results of financial deregulation, including the regulation of financial institutions, and the credit laws and fair trading laws that affect financial institutions, the Committee put forward a recommendation that financial system regulation should be organized on a twin peaks basis with two principal authorities:

1. The Australian Prudential Regulation Authority (APRA), responsible for prudential supervision of ADIs (banks, building societies, credit unions), insurers, and most of the superannuation industry; and

2. The Australian Securities and Investments Commission (ASIC), an expanded version of the old Australian Securities Commission

[1] Australian Prudential Regulation Authority website, www.apra.gov.au. Figures are current as of June 2008.

[2] International Monetary Fund Country Report No. 06/372, October 2006.

[3] Department of Foreign Affairs and Trade website, www.dfat.gov.au/facts/global_economy.html.

[4] Jeffrey Carmichael, *Some Reflections on Where We Have Been and Where We are Heading*, APRA, August 8, 1998. www.apra.gov.au/Speeches/98.05.cfm?RenderForPrint=1.

[5] Ibid.

(ASC), responsible for market conduct relative to financial services and general corporate and business legal standards.

The Reserve Bank of Australia (RBA) continues to be responsible for financial stability, monetary policy, and payment systems. Two other agencies impact financial services providers: the Australian Competition and Consumer Commission (ACCC), which is responsible for market conduct for nonfinancial institutions and a range of general consumer protection and antitrust issues and vets most substantial financial sector mergers; and the Australian Transaction Reports and Analysis Center (AUSTRAC), which regulates anti-money laundering and counterterrorism financing for financial and nonfinancial institutions.

Statutory Framework

The legislation granting authority to APRA, ASIC, and RBA includes the *Australian Prudential Regulation Authority Act 1998*, the *Australian Securities and Investments Commission Act 2001*, the *Reserve Bank Act 1959*, the *Banking Act 1959*, and the *Financial Sector (Collection of Data) Act 2001*.

The *Banking Act 1959* regulates banking and contains provisions relating to the licensing of ADIs; the protection of depositors; APRA's powers to obtain information from ADIs; APRA's powers to issue directions to, or take control of, an ADI; and mergers and restructures of ADIs.

The *Reserve Bank Act 1959* established the RBA as Australia's central bank and empowers it to conduct monetary policy in line with the objectives set out in Section 10(2) of the Act. In addition to the conduct of monetary policy, the Reserve Bank:

- Holds Australia's foreign exchange reserves;
- Operates Australia's main high-value payments system;
- Provides banking services to the government; and
- Designs, produces, and issues Australia's banknotes.

While the RBA has not had any responsibility for the prudential supervision of banks since 1998, it has a general responsibility to promote stability in the Australian financial system. In 1998, the *Reserve Bank Act 1959* was amended to establish the Payments System Board (PSB) within the RBA to promote the safety and efficiency of the Australian payments system. New legislation—the *Payment Systems (Regulation) Act 1998* and the *Payment Systems and Netting Act 1998*—was introduced, giving the Bank relevant powers in this area.[6]

The *Australian Prudential Regulation Authority Act 1998* established APRA as the prudential regulator of regulated financial institutions and sets out the framework for APRA's operation. APRA is required to balance financial safety and efficiency, and competition, and to promote financial system stability. (Reflecting the fact that Australian banks control 90 percent of New Zealand banking assets, APRA is also required to avoid actions that could have a detrimental effect on financial system stability in New Zealand.)

The *Insurance Act 1973* and the *Life Insurance Act 1995* charge APRA with a duty to protect insurance policyholders. The *General Insurance Reform Act 2001* amended the *Insurance Act 1973*, and supports APRA's prudential supervision framework for general insurance, and gives

[6] Reserve Bank of Australia website, www.rba.gov.au/AboutTheRBA/History/history_of_the_rba.html.

it increased flexibility for establishing and enforcing more stringent standards on capital adequacy, liability valuation, risk management, and reinsurance.

The *Australian Securities and Investments Commission Act 2001* established ASIC's role of monitoring the market conduct of corporations registered under the Act, which includes all banks. Some Acts administered by the former Insurance and Superannuation Commission, which contained both prudential and market integrity and disclosure requirements, were split between APRA and ASIC. The *Financial Services Reform Act 2001*, administered by ASIC, provides for streamlined regulation of financial products, operation of financial markets, clearing and settlement, financial service provision, and disclosure.

The *Financial Sector (Collection of Data) Act 2001* shifted responsibility for the registration of financial corporations from the RBA to APRA. The Act applies to financial corporations not already covered by the *Banking Act 1959*. Financial corporations include a wide range of financial intermediaries, including money market corporations, finance companies, general financiers, and pastoral finance companies (rural lenders), which are required to register with APRA for statistical purposes. However, it does not empower APRA to supervise the activities of registered financial corporations (RFCs), and registration does not imply any kind of guarantee or supervision of the firms.

Since 2001, ASIC and the financial services industry have been implementing numerous changes mandated by the *Financial Services Reform Act 2001*. APRA, ASIC, and RBA have the authority to issue standards and guides. APRA has the authority to issue *Prudential Standards*, which set out APRA's prudential requirements for all ADIs and life and general insurers, and *Prudential Practice Guides*, which provide guidance and elaboration in relation to how regulated institutions may comply with the associated standard. ASIC interprets the laws through issuance of guidelines, preferred practices, regulatory guides (formerly known as policy statements), and approval of codes of conduct.

The *Financial Transaction Reports Act 1988* (FTR Act) established the Australian Transaction Reports and Analysis Centre (AUSTRAC), Australia's anti-money laundering and counterterrorism financing regulator and specialist financial intelligence unit. The *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (*AML*) superseded the *FTR Act*. The AML implements a risk-based approach to regulation; that is, reporting entities will determine the way in which they meet their obligations based on their assessment of the risk of whether providing a designated service to a customer may facilitate money laundering or terrorism financing.[7]

Nonstatutory Elements

Australian Competition and Consumer Commission (ACCC)

The ACCC oversees competition in the financial system, including scrutinizing bank and insurance company takeovers and mergers and preventing anticompetitive conduct by banks and other financial institutions.

Financial Sector Advisory Council (FSAC)

The government established the FSAC as part of the financial sector reforms responding to the 1997 Financial System

7 www.austrac.gov.au/aml_ctf.html.

Inquiry. The FSAC is a resource for eliciting and distilling the views of both industry and regulators. The FSAC is recognized by regulators and industry representatives as an important part of the framework, and provides independent advice to the government.

The Australian Stock Exchange (ASX) and the Sydney Futures Exchange (SFE)

The ASX and SFE monitor market participant and company compliance with their business and listing rules. This role is supported by ASIC, which has overall regulatory responsibility for securities and futures markets.

Institutional Structure of the Regulators

The current Australian structure can be described as a twin peaks system, with APRA taking responsibility for prudential regulation and ASIC responsibility for market conduct.

Commonwealth Treasury

Treasury coordinates with a variety of agencies to promote sound economic policy. It is a member of the Council of Financial Regulators, the coordinating body of Australia's main financial regulatory agencies. The Governor-General, on the recommendation of the Treasurer, is responsible for the appointment of directors to the RBA (including the Governor and Deputy Governor) and the Members/Commissioners of APRA and ASIC. The Treasurer has power to direct APRA on matters of policy and operational priorities, if needed. This power has not been exercised, and the expectation is that it will not be exercised other than in extraordinary circumstances.

Reserve Bank of Australia (RBA)

The stability of the financial system, the safety and reliability of the payments system, and monetary policy are the responsibility of the RBA. The RBA is the sole currency-issuing authority and acts as banker to the federal government. The RBA is responsible for overall financial system stability and is lender of last resort to ADIs. The RBA implements financial stability standards for central counterparties and securities settlement facilities. These standards seek to ensure that clearing and settlement facilities identify and properly control risks associated with their operations. The RBA is formally responsible for ensuring that licensed facilities for the clearing and settlement of securities and derivatives conduct their affairs in a way that is consistent with financial system stability.

The RBA has two boards with complementary responsibilities, the Reserve Bank Board and the Payments System Board (PSB), both accountable to the Australian Parliament. The Reserve Bank Board is responsible for monetary policy and overall financial system stability. The PSB has specific responsibility for the safety and efficiency of the payments system. The Governor of the Reserve Bank chairs the PSB, and other Board members include one other RBA representative, one representative from APRA, and up to five other members who are usually drawn from the financial markets community.

The Reserve Bank Board is composed of nine members: three ex officio members—the Governor (who is Chairman), the Deputy Governor (who is Deputy Chairman), and the Secretary to the Treasury—and six external members, all of whom are appointed by the Governor-General on the recommendation of the Treasurer. Members of the Board may not be a director, officer, or an employee of an ADI.

The RBA earns the bulk of its income from the portfolio of financial assets that it holds primarily to conduct monetary policy.

Australian Prudential Regulation Authority (APRA)

APRA is the prudential regulator of banks and other deposit-taking institutions, life (including friendly societies) and general insurance companies, and most of the superannuation industry. APRA has the dual role of regulating bodies in the financial sector and developing the administrative practices and procedures to be applied in performing that regulatory role, including the making of prudential standards.

APRA collects statistical data from all its regulated entities and a range of financial intermediaries and providers under the *Financial Sector (Collection of Data) Act 2001*. The Act, as it relates to registered financial corporations (RFCs),[8] requires a wide range of non-ADI financial intermediaries to register with, and provide statistics to, APRA. APRA does not supervise the activities of these RFCs.

Superannuation funds operating through a third party trust structure, where trustees hold the superannuation assets on behalf of members, are regulated by APRA. These funds may draw together many members from a company or industry or may offer superannuation products to the public on a commercial basis. (Small funds where the trustees are the only members of the fund are regulated by the Australian Taxation Office.

APRA is responsible for dealing with institutions that are unable to meet their prudential obligations. With respect to ADIs, it undertakes this action in close cooperation with the RBA but, as with all institutional types under its responsibility, it is required to directly inform the relevant Minister when an entity is in serious difficulty. The RBA retains its existing role in providing liquidity support to financial institutions if such assistance is required.

Operational effectiveness of the "depositor protection" provisions overseen by APRA provides for early intervention in a financially troubled institution and makes clear that the regulator can close an insolvent entity. APRA was also given enhanced powers to take action in the case of financial difficulties experienced by life and general insurance companies and superannuation funds. In the event of failure of an ADI, depositors are protected by means of a first priority claim against the assets of the ADI. In addition, the government recently announced the introduction of a Financial Claims Scheme to provide depositors with early access to their funds (up to A$20,000) in a failed ADI. The Scheme is to be administered by APRA.

APRA is accountable to the government and the Parliament. It is, however, subject to an overriding policy determination power of the Treasurer in the rare event of an unreconciled disagreement with the government (although such an event has not occurred in APRA's history). APRA's full-time Executive Group is composed of three to five members who are appointed

8 RFCs are defined as such if their assets are over A$5 million, their principal business in Australia is the borrowing of money and provision of finance, and they are not already covered by the *Banking Act 1959*.

by the Governor-General on the recommendation of the Treasurer. The Governor-General appoints a full-time APRA member as Chair and may appoint another full-time APRA member as Deputy Chair of APRA. At least three of the APRA members are appointed as full-time members, and each of the other APRA members (if any) may be appointed as a full-time or part-time member. APRA's Executive Group is responsible and accountable for the operation and performance of the organization. The Group's responsibilities include the development of regulatory and supervisory policies relating to the performance of its role as prudential regulator.

APRA is largely financed by fees imposed on the financial sector entities it supervises as determined and collected by the Australian government—as a levy on supervised entities.

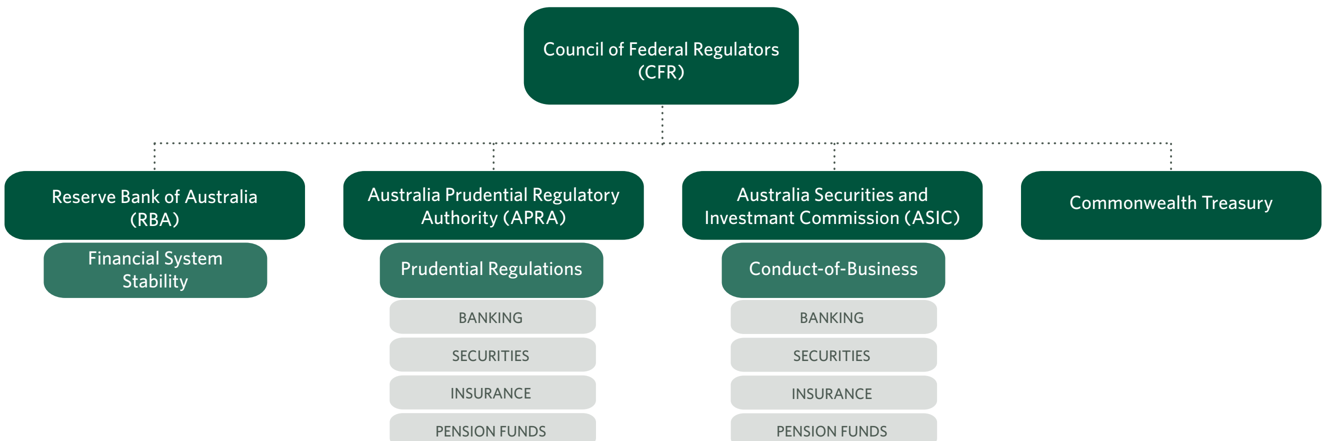
Australian Securities and Investments Commission (ASIC)

ASIC began operating in 1991 as the Australian Securities Commission (ASC), and in 1998 became the Australian Securities and Investments Commission (ASIC), the regulator responsible for market integrity and consumer protection across the financial system. ASIC regulates financial markets, financial services organizations, and professionals who deal with and advise about investments, superannuation, insurance, deposit taking, and credit. ASIC regulates venture capital funds and private equity firms, although it regulates some aspects of money market corporation operations (such as compliance with the fundraising and securities licensing provisions of the Corporations Law). ASIC does not undertake prudential supervision.

ASIC may interpret the laws through issuance of guidelines, preferred practices, regulatory guides, and approval of codes of conduct. ASIC has undertaken a number of *Better Regulation Initiatives* that aim to achieve better and more transparent regulation and to reduce burdens on business.

The Ministers responsible for ASIC are the Treasurer and the Minister for Superannuation and Corporate Law. ASIC operates under the direction of three full-time Commissioners appointed by the

FIGURE 15. The Financial Services System Regulatory Structure, Australia



Note: Dotted lines indicate a cooperative relationship.

Governor-General on the nomination of the Treasurer. The Commissioners report to the Ministers through their annual report, and through briefings, submissions, and meetings with the Treasurer or Parliamentary Secretary.

Funding for ASIC comes from allocations within the annual budget of Parliament.

Figure 15 provides a graphic depiction of the relationship among the above-mentioned institutions.

Enforcement

APRA's prudential framework is largely principles based. Implementation is based on an ongoing dialogue between supervisors and regulated entities. Where significant difficulties arise, intervention by APRA is proportionate to the seriousness of the problem and the level of risk to depositors, policyholders, and the financial system. APRA has a broad range of supervisory powers that escalate from preventive, to corrective, to failure management.

APRA has the authority to establish standards on prudential matters in relation to ADIs and insurers; however, it does not have standards-making powers in superannuation. APRA implements its prudential standards pursuant to its ongoing supervisory activities, usually without resorting to its legal powers. However, APRA has power to issue a "direction" to a licensed institution requiring it to comply with a prudential standard or regulation, or to otherwise act in the interests of depositors or policyholders.

The government is not legally obligated to consult ASIC in its legislative and policy formulation, and there is no formal mechanism for such consultation. ASIC does have enforcement powers. "Enforceable undertakings" are one of a number of remedies available to ASIC for violations of the law. It is an administrative settlement and may be accepted as an alternative to court action or certain other administrative actions. It can apply to the Courts for action to be taken against breaches.

Framework for Domestic Coordination

The Council of Financial Regulators (CFR) is the coordinating body for Australia's main financial regulatory agencies. Its membership is composed of the RBA, which chairs the Council, APRA, ASIC, and the Australian Treasury. The CFR provides a forum to address emerging trends and policy issues. The Council contributes to the efficiency and effectiveness of financial regulation by providing a high-level forum for cooperation and collaboration among its members. It operates as an informal body in which members are able to share information and views, discuss regulatory reforms or issues where responsibilities overlap and, if the need arises, coordinate responses to potential threats to financial stability. In the event of a crisis, the CFR would serve as the key coordinating body for developing an official response.

The Council advises the government on the adequacy of Australia's financial system architecture in light of ongoing developments. The Council is nonstatutory and has no regulatory functions separate from those of its members. Given the important role played by each of these entities in the formulation of financial institutions policy, in interacting with foreign counterparts, and in monitoring and evaluating trends in domestic and international markets, the CFR is an important forum for the Australian financial sector.

APRA has Memoranda of Understanding (MoUs) with the ACCC, ASIC, the RBA, the Australian Taxation Office, the Commissioner for Fair Trading, the Department of Commerce, the Financial Reporting Council, the Office of Fair Trading, and the Treasury. It also has MoUs with a number of offshore prudential supervisors.

The APRA/RBA MoU addresses cooperation and coordination in instances involving threats to the financial system's stability, participation by the RBA in prudential consultations, and the establishment of a coordination committee to ensure that appropriate arrangements are in place to respond to threats to system stability and for coordinating information sharing. The APRA/Treasury MoU addresses information sharing, advising on emerging developments in the financial system, and informing the Treasurer of situations that can cause financial distress or instability. APRA and AUSTRAC have signed an MoU to facilitate cooperation and the exchange of information between the two regulators.

International Coordination

The high interdependence of the Australian and New Zealand banking systems led to the formation, in 2005, of the Trans-Tasman Council on Banking Supervision (TTC). The goals of the TTC are to enhance information sharing, promote a coordinated response to financial crises, and guide policy advice to the governments in relation to banking supervision. An MoU between ASIC and the New Zealand Companies Office was signed in 2006, moving the regulatory alignment closer. To promote more consistent regulation between Australia and New Zealand, ASIC signed a new MoU with the New Zealand Securities Commission and an MoU with the New Zealand Registrar of Companies. The governments of Australia and New Zealand also recently exchanged letters marking the commencement of the Trans-Tasman Mutual Recognition of Securities Offering Regime, which will allow a single disclosure document to be used in both Australia and New Zealand.

The TTC recommended legislative changes to lay the foundation for enhanced cooperation between APRA and the Reserve Bank of New Zealand, and these changes have been implemented. The two regulators are required to support each other in fulfilling their statutory objectives and, where feasible, to avoid actions that could have a detrimental effect on financial system stability in the other country. It provides for APRA to support the Reserve Bank of New Zealand in the performance of its statutory responsibilities relating to financial system stability and prudential regulation in New Zealand. The future TTC work program includes improving cooperation in crisis management, which would build on work currently underway in both countries.

Under the Australia-Indonesia Partnership for Reconstruction and Development, ASIC helped strengthen the Indonesian capital markets supervisory agency, Bapepam-LK, in enforcement and surveillance. This is a pilot for broader ASIC assistance to promote financial stability in the region. APRA also provides technical and strategic advice to Bapepam-LK on risk-based supervision and related matters.

Please refer to the chart of international coordination activities and organizational participation on page 234.

Current Issues

Australian Authorities are pursuing initiatives to develop a formal process to manage the failure of individual institutions and more widespread crises. Historically, failures of financial institutions in Australia are rare. As a result, responses to troubled institutions have tended to be ad hoc rather than based on the remedial powers of the *Banking Act* or insurance legislation. This history, in which there have been no losses borne by depositors in a failed bank since the *Banking Act* was introduced in 1945, has led to a widespread public perception that the government will be compelled to intervene to bail out depositors in failed ADIs.

The current institutional arrangements for financial stability have not been tested. The failure in 2001 of a large insurance entity highlighted the need for improved arrangements to manage the failure of financial institutions and contingency planning for crisis management. Government intervention to compensate policyholders, coupled with the history of arranged mergers and state government support for failing banks, has contributed to the expectation that the government would guarantee or bail out policyholders or depositors in a failed ADI. The government has recently announced the introduction of a Financial Claims Scheme to provide compensation to policyholders of a failed general insurer and to provide depositors with timely access to their funds in a failed ADI. The Scheme forms part of an enhanced framework for failure resolution and crisis management.

ACRONYMS AND ABBREVIATIONS

A$	Australian dollars
ACCC	Australian Competition and Consumer Commission
ADIs	Authorized Deposit-Taking Institutions
AML	*Anti-Money Laundering and Counter-Terrorism Financing Act 2006*
APRA	Australian Prudential Regulation Authority
ASC	Australian Securities Commission
ASIC	Australian Securities and Investments Commission
ASX	Australian Stock Exchange
CFR	Council of Financial Regulators
FSAC	Financial Sector Advisory Council
FTR Act	*Financial Transaction Reports Act 1988*
MoUs	Memoranda of Understanding
PSB	Payments System Board
RBA	Reserve Bank of Australia
RFCs	Registered financial corporations
SFE	Sydney Futures Exchange
TTC	Trans-Tasman Council on Banking Supervision

THE NETHERLANDS

Market Description

The Netherlands has approximately 1,800 licensed financial institutions, with total assets of approximately €5 trillion (euros).[1] However, as the Dutch financial market has undergone a process of consolidation in recent decades, a small number of financial conglomerates providing banking and insurance services have come to dominate the market. At present, foreign banks play only a limited role in the Dutch retail market and are principally active in the wholesale market. The takeover of the Dutch bank ABN AMRO by three foreign banks, however, at end-2007, marked a turning point in the domestic consolidation process.

The Dutch pension fund industry is significant, given the pension structure in the Netherlands, and is composed of both a small number of large pension funds and numerous smaller pension funds. Consolidation in the pension fund sector began a few years ago and is still in progress.

Background

The current Dutch financial regulatory structure can be described as a twin peaks system. De Nederlandsche Bank (DNB), the Dutch central bank, is responsible for prudential and systemic supervision of all financial services. The Netherlands Authority for the Financial Markets (AFM), is responsible for the conduct-of-business supervision in the Dutch financial markets. The Ministry of Finance is politically responsible for the functioning of the financial system, for the institutional structure of supervision, the legislation, and the use of public funds in crisis situations.

Until the late 1990s, financial supervision in the Netherlands was sector based, with DNB responsible for the supervision of banks, collective investment entities, and exchange offices. The Securities Board (STE), predecessor of the AFM, supervised all the participants in the securities trade. The Pension and Insurance Supervisor (PVK) exercised prudential supervision over insurers and pension funds. With the increased diversification and mergers of financial sector institutions, DNB, the STE, and the PVK created the Council of Financial Supervisors (RFT) in 1999, to cooperate on cross-sectoral issues.

Soon after, however, the public authorities decided to abandon the sector-based approach and replace it with a division of duties into prudential and market conduct supervision. The decision was taken in response to two clear trends: the consolidation of the Netherlands' financial sector into one dominated by a few large companies conducting business across multiple product types and lines, and the development of complex financial products that have cross-sector elements. This fundamental reform of the financial regulatory system into a twin peaks structure was in place by 2004, including the PVK merger with DNB. The key legislative changes were in place by 2007.

Under the new regime, DNB assumed responsibility for the prudential supervision of all financial institutions and the financial system as a whole (that is, systemic supervision). The STE was transformed into the AFM and became market conduct supervisor, with a view, among others, to consumer protection.

[1] De Nederlandsche Bank (DNB) Statistical bulletin.

Statutory Framework

The role of DNB was defined in the 1948 *Bank Act*, under which DNB had joint responsibility with the Ministry of Finance for the stability of the value of money. In 1952, the role of DNB as the supervisor of the banking system was statutorily formalized, and expanded in the following years to include all credit institutions.

The *Act on the Supervision of the Credit System of 1952* "the Act" established the statutory basis for banking supervision. The Act encompasses credit institutions, a collective term that includes general banks, banking cooperatives, savings banks, securities banks, and capital market institutions, such as mortgage banks. Initially, the Act distinguished between monetary supervision and prudential supervision. Monetary supervision empowered DNB to control lending by private banks. Under the Act (and subsequent amendments), DNB's supervisory activities were again expanded, enabling it to target systemic risk. During the 1980s and 1990s, DNB's duties were further expanded to include supervision of collective investment entities and exchange offices.[2]

DNB's financial supervisory role was transformed in 2002, when it was given responsibility for prudential supervision of financial institutions and the soundness of the financial system. At the same time, market conduct supervision was entrusted to the AFM.

The legal underpinning of the reform of the Netherlands' financial supervisory system was completed with the *Financial Supervision Act* (WFT), in January 2007, providing one main act along with various decrees and regulations concerning the supervision of the financial sector. The WFT clarifies and strengthens the framework for financial sector supervision and sets out the requirements that financial services providers must meet. The WFT replaced seven supervision acts, which were structured along traditional sector lines. The WFT clearly delineates the tasks between DNB—in the area of prudential supervision—and the AFM—relating to market conduct or conduct-of-business supervision.

In addition to the WFT, there are a few acts that regulate specific segments of the financial sector. Pension funds are supervised on the basis of the *Pension Act* (PW) and the *Obligatory Occupational Pension Schemes Act*. The PW is a modernization and technical revision of the previous *Pensions and Savings Fund Act*, which entered into force at the same time as the WFT, in January 2007. DNB supervises trust offices and money transaction offices on the basis of the *Supervision of Trust Offices Act* and the *Money Transaction Offices Act*, which supervision focuses on integrity. The AFM supervises audit firms on the basis of the *Act on Supervision of Audit Firms* and financial reporting of listed Dutch companies on the basis of the *Act on the Supervision of Financial Reporting*. Both DNB and AFM supervise financial institutions on the basis of the *Identification (Financial Services) Act* (WID) and the *Disclosure of Unusual Transactions (Financial Services) Act* (Wet Mot). WID and Wet Mot will be integrated in 2008 into a new *Act on the Prevention of Money Laundering and Financing of Terrorism*.

Nonstatutory Elements

No nonstatutory elements have been noted.

[2] The history of DNB is available at www.dnb.nl.

Institutional Structure of the Regulators

As mentioned, the financial regulatory structure in the Netherlands can be described as a twin peaks system. The following institutions are involved.

The Ministry of Finance

The Ministry of Finance has no supervisory responsibilities, with one major exception. The Minister of Finance, with DNB, has to grant permission for a takeover or merger in which one of the five largest banks or insurers in the Netherlands is involved, as was the case with the takeover of ABN AMRO.

De Nederlandsche Bank (DNB)

DNB has a dual status, being both a member of the European System of Central Banks (ESCB) as a central bank, and an independent public body, as a supervisory authority. DNB exercises prudential supervision of financial institutions (credit institutions, insurers, collective investment schemes, investment firms, and pension funds), and of integrity-related supervision over money transactions offices and trust offices.

DNB has established a specialized Financial Stability Division, which analyzes the interplay between prudential supervision and systemic and monetary stability issues. The division examines the degree to which the financial system can absorb shocks. This involves a continuous examination of potential risks and vulnerabilities, including concentration risk and the second-round effects of financial instability.

DNB executes a Deposit Guarantee Scheme, in case a bank fails, which guarantees balances up to €40,000 per account holder per institution (regardless of the number of accounts held). For each account holder, the amount over €20,000 is subject to a 10 percent account holder risk. The compensation under the scheme cannot be more than €38,000 per account holder. DNB will pay out compensation under the Deposit Guarantee Scheme and can subsequently apportion the total sum paid among the participating banks according to size.[3]

DNB's day-to-day management rests with the Governing Board, which consists of a President and up to five Executive Directors, appointed by the Crown to seven-year terms. DNB also has a Supervisory Board and an advisory body, called the Bank Council. The Supervisory Board supervises management of the DNB's affairs and adopts the annual balance sheet and profit-and-loss account. One member of the Supervisory Board is appointed by the government. The Supervisory Board approves the budget, and then the portion of the budget applicable to DNB's supervisory activities is submitted to the Ministers of Finance and of Social Affairs and Employment for approval. The Bank Council offers advice to the Governing Board. Two Supervisory Board members sit on the Bank Council, including the government-appointed Supervisory Board member. DNB's supervision is partly funded by the financial institutions via contributions and the government. DNB has more than 1,600 employees (full-time equivalents), including approximately 400 employees with a primary focus on supervisory activities. In 2007, DNB's net operating costs were €276 million, and its net profit for the year was €1.621 billion.[4]

---

[3] www.dnb.nl.

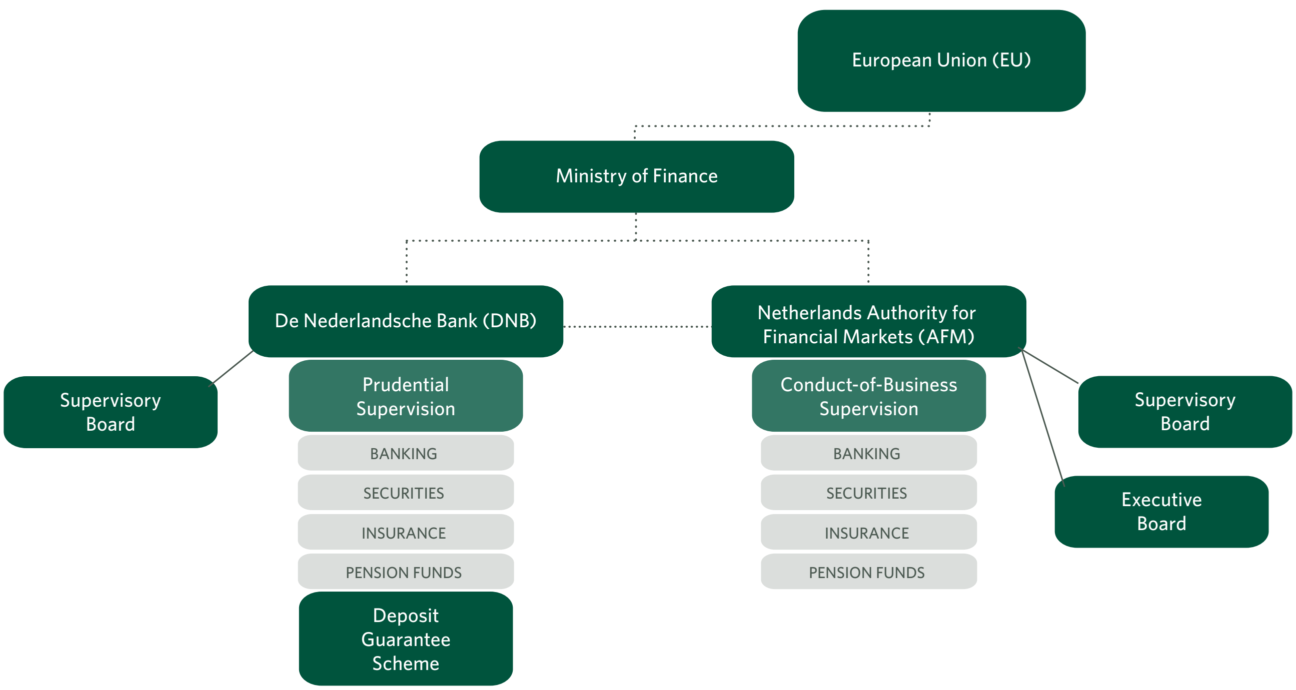
[4] DNB Annual Report 2006, at www.dnb.nl.

The Netherlands Authority for Financial Markets (AFM)

The AFM supervises market conduct and the provision of information by all market participants in the Netherlands: savings, lending, investment, and insurance markets. The overall objective of the AFM is to promote an orderly and transparent market process in the financial markets, the integrity of relations among market players, and the protection of the consumer. This overall objective is translated into three further objectives, which guide the work of the agency: to promote access to the market; to ensure the efficient, fair, and orderly operation of the market; and to guarantee confidence in the market.

The AFM has a five-member Supervisory Board, which is responsible for monitoring whether the AFM's tasks are carried out properly by the Executive Board. The Minister of Finance has the power to appoint and dismiss the members of the Supervisory Board. The Supervisory Board is responsible for approving the AFM's annual plan, budget, and annual financial statements. It also has to approve the Executive Board's resolutions of major strategic importance, such as to adopt or alter policy plans for the medium or long term, change the organizational structure, appoint or dismiss the external auditor, amend the statutes, or accept new tasks.

FIGURE 16. The Financial Services System Regulatory Structure, the Netherlands



Note: Dotted lines indicate a cooperative relationship.

The Executive Board governs the AFM and has ultimate strategic responsibility. The Directors, who report to the Board, are responsible for day-to-day management of the AFM. In contrast to the Executive Board, the AFM Directors do not have joint responsibility; rather, each Director is responsible for only his or her individual mandates as established by the Executive Board.

The AFM operates as an agency of the Minister of Finance. The Minister appoints the members of the Supervisory Board and the Executive Board, and approves the budget and any amendments to the AFM's statutes. The AFM is funded jointly by the institutions it supervises and through the Dutch government budget. It employs approximately 450 people and its operating costs for 2006 were €73.24 million.[5]

Figure 16 provides a graphic depiction of the relationship among the above-mentioned institutions.

Enforcement

Both financial supervisors—DNB and the AFM—have similar broad powers of enforcement, based on the above-mentioned Acts. They decide on the admission of financial undertakings to the financial markets and are empowered to withdraw licenses. Firms cannot use the word "bank" in their title unless authorized by DNB. If the supervisors find violations of said Acts, they can take various measures, including issuing an instruction, appointing an administrator, or imposing sanctions like cease and desist orders, under penalty or administrative fines. Moreover, the supervisors can publicize a public warning or report a case to the Public Prosecutions Department (*Openbaar Ministerie*).

Framework for Domestic Coordination

In their capacities as prudential supervisor and market conduct supervisor, respectively, DNB and AFM work closely together. They have concluded the so-called Covenant, which outlines the procedures for cooperation and coordination in regulation and ongoing supervision. The latter includes licensing and regular supervisory inspections, special measures, and other functions.

Also, representatives from DNB and the Ministry of Finance at all levels meet frequently and regularly to discuss supervisory and financial stability issues, although generally not concerning specific institutions, given the confidentiality of supervisory information. The Ministry of Finance and DNB have had a Memorandum of Understanding (MoU) since 2007, which outlines the procedures for the management of financial crises. The MoU sets out principles of coordination, not operational details, as both the Ministry and DNB agree that in a crisis, speed is of prime importance. When faced with a possible financial crisis or banking failure, DNB has the lead role, while the Ministry remains informed, if necessary, on specific institutions, and will be involved if measures by the Minister are needed. The AFM does not have a formal crisis management role under the MoU. However, the agency is informed of actions taken by DNB and the Ministry, according to the Convenant.

International Coordination

Please refer to the chart of international coordination activities and organizational participation on page 234, and to the European Union profile for an explanation of coordinating activities within the EU.

[5] AFM Annual Report 2006, at www.afm.nl.

ACRONYMS AND ABBREVIATIONS

AFM	Netherlands Authority for the Financial Markets (Autoriteit Financiële Markten)
DNB	De Nederlandsche Bank
ESCB	European System of Central Banks
€	Euro
MoU	Memorandum of Understanding
PVK	Pension and Insurance Supervisor (Pensioen- en Verzekeringskamer)
PW	Pension Act (Pensioenwet')
RFT	Council of Financial Supervisors (Raad voor de Financiële Toezichthouders)
STE	The Securities Board (Stichting Toezicht Effectenverkeer)
Wet Mot	*Disclosure of Unusual Transactions (Financial Services) Act (Wet melding ongebruikelijke transacties)*
WFT	*Financial Supervision Act (Wet op het financieel toezicht)*
WID	*Identification (Financial Services) Act (Wet identificatie bij dienstverlening)*

THE EXCEPTION

United States of America

UNITED STATES OF AMERICA

Market Description

The U.S. financial services system accounts for approximately 8 percent of the country's gross domestic product, and by assets is the largest financial system globally. There are more than 31,000 regulated financial services providers in the United States, providing banking, securities, investment management, and insurance services. This includes approximately 9,000 banks and bank or financial holding companies, 8,000 credit unions, 7,600 insurance providers, 5,000 brokerage firms, 1,300 thrifts and thrift holding companies, and 500 investment management firms. The complexity of the U.S. system is created, in part, by the differences in the regulatory oversight of banking, securities, and insurance. In the United States, federal and state agencies provide oversight and guidance for banking and securities, but states supervise insurance. In addition, different federal and state agencies regulate each sector.

The U.S. market also contains a significant number of unregulated or lightly regulated financial services providers, including hedge funds, private equity and other private pools of capital, mortgage brokers, check cashers, money transmittal firms, and payday loan providers. This segment of the market, (that is, the unregulated or lightly regulated segment), which ranges from relatively small entities operating in local markets to large global firms with investments or exposures that transcend national boundaries, poses significant challenges to U.S. regulators. The recent mortgage lending crisis in the United States is focusing attention on certain of these unregulated and lightly regulated market activities.

Background

The structure of the U.S. financial services regulatory regime is admittedly complex, and reflects such factors as the federalist nature of the United States, responses to financial crises, solutions to specific problems, developments or regulatory gaps, and efforts to modernize the financial system over time. While successful in the past, the credit and financial market turmoil over the last year has focused attention on the efficacy of the U.S. system in meeting the goals of financial supervision, including promoting safety and soundness of individual institutions, market integrity, investor and customer protection, and financial stability.

The U.S. system of supervision and regulation comprises both functional regulation of activities (for example, banking, securities, commodities, insurance) and consolidated supervision. The latter is a guiding principle of bank and thrift supervision, as exercised by the Federal Reserve through its bank and financial holding company responsibilities, and by the Office of Thrift Supervision (OTS) of thrift holding companies. In recent years, efforts by the Securities and Exchange Commission (SEC), through the Consolidated Supervised Entity program, have also extended the principle of consolidated supervision to some of the country's largest securities firms.

A distinguishing feature of the U.S. banking system is its dual nature, in which banks have a choice of state or national charters. For a long period after the founding of the country, states played a major role in chartering financial institutions, providing for their supervision, and establishing the earliest depositor protection schemes. Indeed, the First and

Second Banks of the United States were the only federally chartered institutions until passage of the *National Currency* and *National Bank Acts* in the 1860s. These laws provided for federally or nationally chartered banks and established the Office of the Comptroller of the Currency (OCC) as the national bank supervisor. Since that time, competition in charter choice has been viewed as an important source of innovation in, and development of, the U.S. banking system. The creation of the Federal Reserve in 1913 provided for the supervision of member banks, extending federal oversight to state-chartered institutions that were members of the Federal Reserve.

The stock market crash of 1929, followed by the Great Depression of the 1930s, (and a decrease in the number of banking institutions by approximately 10,000, or roughly 40 percent), saw a marked change in the structure of financial services regulation that would define supervisory oversight for decades. The various regulatory agencies in operation today, or their predecessors, were established during this turbulent period in U.S. history. Key legislation of this period created the Federal Deposit Insurance Corporation (FDIC), which established the deposit insurance framework and provided for the supervision of state nonmember banks; separated commercial and investment banking under the *Banking Act of 1933* (otherwise known as the *Glass-Steagall Act*); and established the SEC under the *Securities Exchange Act* to regulate the U.S. securities markets in combination with Self-Regulatory Organizations (SROs) that are subject to SEC oversight. This period also saw the creation of the Federal Home Loan Bank Board and the Commodity Exchange Commission, predecessors to the OTS (established by the *Financial Institutions Reform, Recovery, and Enforcement Act* in 1989) and the Commodity Futures Trading Commission (CFTC) in 1974.

The formation of bank holding companies over time, in part to circumvent restrictions on interstate and non-banking activities, led to passage of the *Bank Holding Company Act* in 1956, and the 1970 Amendments, which gave the Federal Reserve authority to approve and supervise such entities. Another key development in the structure of financial system oversight in the United States was the *Federal Deposit Insurance Corporation Improvement Act of 1991*, which substantially increased the federal role in the establishment and supervision of offices of foreign banks in the United States. Events, such as the closing of the Bank of Credit and Commerce International (BCCI), a foreign bank operating in the U.S. without a home country consolidated supervisor, pointed to the need for tighter control over banks entering the United States; for comprehensive, consolidated supervision by the home country supervisor; and for enhanced supervision of foreign banks operating in the United States. The *Foreign Bank Supervision Enhancement Act* (Title II of the Act) established the Federal Reserve as the umbrella supervisor for the U.S. operations of foreign banking organizations.

The *Gramm-Leach-Bliley Act of 1999* (GLBA) repealed provisions of the *Glass-Steagall Act* that restricted the ability of bank holding companies to affiliate with securities firms and insurance companies, and permitted the establishment of diversified financial holding companies. The GLBA's intent was to modernize the financial services industry, rather than to be a response to crisis or scandal. The Federal Reserve serves as the umbrella or consolidated supervisor of Financial Holding Companies (FHCs), relying "to the fullest extent possible" on functional regulators, and in its consolidated oversight, evaluates the financial strength and stability of the FHC, its consolidated risk management and control processes, and overall capital adequacy. The Federal Reserve may examine a functionally regulated non-bank subsidiary of the FHC under certain conditions (for example, if the subsidiary is engaged in activities that present a material risk to affiliated depository institutions).

Banking and securities activities are generally regulated at both the state and federal levels, insurance at the state level, and futures principally at the federal level. Five federal agencies—the Federal Reserve, the OCC, the FDIC, the OTS, and the National Credit Union Administration (NCUA)—oversee banking and thrift institutions and credit unions. State and federal banking agencies jointly oversee state-chartered banking institutions and thrifts.

The complex array of supervisory agencies requires a high degree of coordination, and supervisors have worked out processes for limiting overlap and enhancing resource efficiencies. These include arrangements between state and federal supervisors for state-chartered institutions, between holding companies and federally chartered bank subsidiaries, and between the OCC and the Federal Reserve and the FDIC. At a broader level, in 1978, Congress established the Federal Financial Institutions Examination Council (FFIEC), which includes the executives of the five agencies, as a forum for the various federal agencies to discuss issues of common concern and to seek consistency in their approaches to supervision and regulation. State supervisors have also established coordinating bodies, such as the Conference of State Bank Supervisors (CSBS) for bank supervisors, and the National Association of Insurance Commissioners (NAIC) for insurance supervisors.[1]

Statutory Framework

The *National Bank Act of 1863* was motivated by the need to finance the Civil War. It provided for nationally chartered banks, which would be supervised by the OCC, a bureau of the U.S. Department of the Treasury.

The *Federal Reserve Act of 1913* was enacted in response to a series of financial panics and economic problems in the late 19th and early 20th centuries. The legislation created a means of ensuring the availability of currency to meet emergency needs. In addition, it provided for the creation of the Federal Reserve System, including the Board of Governors in Washington, D.C., and the Federal Reserve Banks, and established the powers of the Federal Reserve, including the conduct of open market operations, lending through the discount window, and the supervision of state member banks.

The *Banking Act of 1933*, also known as the *Glass Steagall Act*, was enacted to remedy some of the problems exposed by the beginning of the Great Depression. It created the FDIC and provided for federal deposit insurance, established procedures for handling insolvent banks, established enforcement powers for bank regulators, and addressed perceived abuses in bank securities underwriting activities, in part by

[1] For more information, see www.ffiec.gov; www.csbs.org; and www.naic.org.

prohibiting the banks from affiliating with firms engaged in such activities.

The *Securities Act of 1933* was designed to promote the availability of material information to investors and to fight fraud. This Act focuses on the issuers of securities and requires the registration of securities, unless an exception applies.

The *Securities Exchange Act of 1934* was enacted to form the basis for regulation of financial markets and their participants, including brokers, dealers, and clearing entities. The Act created the SEC.

The *Home Owners' Loan Act of 1934* was enacted to provide emergency relief for home mortgage debt, to refinance home mortgages, and to extend relief to the owners of homes occupied by them who are unable to amortize their debt elsewhere. The Act also amended the *Federal Home Loan Bank Act* to increase the market for U.S. obligations and for other purposes. The Act was later amended, and transferred the authority of the Federal Home Loan Bank Board to the OTS as an agency within the Treasury Department responsible for supervising mortgage activities conducted by savings and loan associations and their holding companies.

The *Federal Credit Union Act of 1934* authorized the formation of federally chartered credit unions in all states. The purpose of the federal law was to make credit available and promote thrift through a national system of nonprofit, cooperative credit unions. In 1970, the National Credit Union Administration (NCUA) was formed as an independent federal agency to charter and supervise federal credit unions.

The *Commodity Exchange Act of 1936* was enacted to replace the earlier *Grain Futures Act* and extend federal regulation beyond grain to a wider enumerated list of commodities. The Grain Futures Commission became the Commodity Exchange Commission, which would eventually become the Commodity Futures Trading Commission (CFTC) in 1974, when the Act was amended and extended the CFTC's jurisdiction to futures trading in all commodities, not just those specifically enumerated in the 1936 Act. The Act makes the CFTC the regulator for certain exchange-traded products and for certain market participants, including futures commission merchants and commodity pool operators. The CFTC's mandate has been renewed and expanded several times since then, most recently by the *Commodity Futures Modernization Act* of 2000.

The *Trust Indenture Act of 1939* applies to debt securities such as bonds, debentures, and notes that are offered for public sale. Even though such securities may be registered under the *Securities Act*, they may not be offered for sale to the public unless a formal agreement between the issuer of bonds and the bondholder, known as the trust indenture, conforms to the standards of this Act.

The *Investment Company Act of 1940* regulates the organization of companies, including mutual funds, that engage primarily in investing, reinvesting, and trading in securities, and whose own securities are offered to the investing public. The focus of this Act is on disclosure of information about the fund and its investment objectives, and on investment company structure and operations. The Act does not permit the SEC to directly supervise the investment decisions or activities of these companies or judge the merits of their investments.

The *Investment Advisers Act of 1940* regulates investment advisers. With certain exceptions, this Act requires that firms or sole practitioners compensated for advising others about securities investments must register with the SEC and conform to regulations designed to protect investors. Since the Act was amended in 1996, generally only advisers who have at least US$25 million of assets under management or advise a registered investment company must register with the Commission.

The *McCarran-Ferguson Act of 1945* permitted the states to continue regulating the insurance business after the Supreme Court ruling declaring insurance to be interstate commerce and therefore within Congress's constitutional authority to regulate. Under the Act, insurance is exempt from some federal antitrust statutes to the extent that it is regulated by the states. The exemption primarily applies to gathering data in concert for the purpose of ratemaking. Otherwise, antitrust laws prohibit insurers from boycotting, acting coercively, restraining trade, or violating the *Sherman Antitrust Act* or the *Clayton Antitrust Act*.

The *Administrative Procedure Act of 1946* provides a basis for accountability to the public of financial regulators in the United States. The Act prescribes an agency's obligation to make public information about its organization, procedures, and substantive requirements, and to provide advanced notice of proposed rules. Interested parties must be given an opportunity to comment on the rulemaking process. The Act also defines general conditions for judicial review of agency decisions, providing a check on regulatory powers. The procedural requirements of the Act have been developed and refined by subsequent legislation.

The *Federal Deposit Insurance Act of 1950* contains the provisions of law regarding the FDIC and deposit insurance, procedures for the handling of insolvent banks, and bank supervisor enforcement powers, among other supervisory subjects.

The *Bank Holding Company Act of 1956* and the 1970 Amendments define what a "bank holding company" is, control future expansion of bank holding companies, and restrict the non-banking activities in which bank holding companies can engage.

The *Federal Deposit Insurance Corporation Improvement Act of 1991* was passed during the savings and loan crisis. It introduced a formal scheme for prompt corrective action and it required the least-cost resolution of failed depository institutions. Notably, in response to the BCCI scandal, it mandated comprehensive supervision on a consolidated basis as a prerequisite for approval of many applications by foreign banks for offices in the United States.

The *Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994* allows interstate banking in the United States, and permits banks to establish branches nationwide by eliminating all barriers to interstate banking. Before this legislation went into effect, banks were required to establish separate subsidiaries in each state to conduct business, and it was illegal for banks to accept deposits from customers out of their home state.

The *Gramm-Leach-Bliley Act of 1999* provides a framework for the affiliation of banks and other financial services providers, most notably, insurance companies and securities firms. It allows the formal affiliation of such companies under holding companies that were well capitalized and well managed, in part by repealing the relevant sections of the *Banking Act of 1933*, and by making amendments to the *Bank Holding Company Act of 1956*. In addition, it provided that the Federal Reserve would be the umbrella supervisor of the new financial holding companies and that non-bank financial entities or subsidiaries of those holding companies would be supervised by their primary functional regulators.

The *Sarbanes-Oxley Act of 2002* mandates a number of reforms to enhance corporate responsibility, enhance financial disclosures, and combat corporate and accounting fraud, and created the Public Company Accounting Oversight Board (PCAOB), to oversee the activities of the auditing profession. The PCAOB is a private-sector, nonprofit corporation, with four primary responsibilities:

- Registration of accounting firms that audit public companies in U.S. securities markets;
- Inspections of registered public accounting firms;
- Establishment of auditing and related attestation, quality control, ethics, and independence standards for registered public accounting firms; and
- Investigation and discipline of registered public accounting firms and their associated persons for violations of specified laws or professional standards.

Nonstatutory Elements

In addition to the statutory elements of the U.S. system, there are various private standard-setting organizations, including the Financial Accounting Standards Board (FASB), the International Swaps and Derivatives Association (ISDA), and the Securities Industry and Financial Markets Association (SIFMA). Self-regulatory organizations (SROs) have an underlying statutory authority, but are discussed in more detail in this section.

SROs play a significant role in the overall U.S. regulatory regime. As with the FASB, the SEC delegates authority to national and regional exchanges to enforce industry standards with respect to brokerage and trading of securities. In particular, the SROs are responsible for oversight of the securities markets and their participants. This is implemented via standards to which securities market participants are expected to adhere. SROs also monitor business conduct and bring disciplinary actions against their members for violating applicable federal statutes, SEC rules, and their own rules. The SROs are overseen by the SEC, which inspects their operations and reviews their rule proposals.

SROs—including the numerous futures exchanges and the National Futures Association—are also responsible for overseeing the futures industry. Similar to their securities counterparts, futures SROs establish and enforce rules governing member conduct and trading, prevent market manipulation via monitoring of trading activity, and examine members for financial strength and other regulatory purposes. Futures SROs are also responsible for ensuring that industry professionals meet qualifications. The CFTC acts as an independent monitor of exchange trading activity and market participants' financial conditions.[2] These SROs are overseen by the SEC, which inspects their operations and reviews their rule proposals.

Financial Accounting and Standards Board (FASB)

Although not endowed with statutory authority, the FASB serves as the leading private sector organization for the establishment and improvement of financial

[2] For more on SROs, see www.finra.org/index.htm; www.cftc.gov/; and www.nfa.futures.org/.

accounting and reporting standards. Its purpose in doing so is to guide and educate the public, which includes issuers, auditors, and users of financial information. Statutory authority to establish financial accounting and reporting standards lies with the SEC, but the SEC has historically relied on the FASB, even going so far as to recognize the FASB's word as authoritative.

International Swaps and Derivatives Association (ISDA)

The ISDA represents participants in the privately negotiated derivatives industry, and is the largest global financial trade association (by number of member firms). The ISDA was chartered in 1985, and has over 825 member institutions in 56 countries. These members include most of the world's major institutions that deal in privately negotiated derivatives, as well as businesses, governments, and other institutions that rely on over-the-counter derivatives to manage financial market risks. The ISDA's primary purpose is to encourage the prudent and efficient development of the privately negotiated derivatives business.

Securities Industry and Financial Markets Association (SIFMA)

The SIFMA was formed via a merger between the Securities Industry Association and the Bond Market Association, and represents more than 650 member firms of all sizes, in all financial markets in the United States and around the world. Its objectives include ensuring the public's trust in the securities industry and financial markets; encouraging retirement savings and investment; promoting effective and efficient regulation; and facilitating more open, competitive, and efficient global capital markets.

Financial Industry Regulatory Authority (FINRA)

In 2007, the SEC approved a merger of the enforcement arms of the New York Stock Exchange (NYSE) and the National Association of Securities Dealers (NASD), to form the Financial Industry Regulatory Authority (FINRA). FINRA is the largest nongovernmental regulator of securities firms doing business in the United States, and performs market regulation under contract for the National Association of Securities Dealers Automated Quotation System (NASDAQ) Stock Market and various national exchanges.

National Association of Insurance Commissioners (NAIC)

The NAIC is an organization of insurance regulators from the 50 states, the District of Columbia, and the five U.S. territories. The NAIC provides a forum for the development of uniform policy when uniformity is appropriate. It is a private association, not a governmental organization. This status carries two important implications. First, the NAIC has no power to compel the states or the industry; and second, the NAIC is completely self-governing, neither accountable to voters nor subject to government oversight. Thus, although the NAIC has assumed a central and national role in insurance regulation, it cannot sanction regulators or insurers. The industry directly funds the NAIC. Each year the NAIC assesses insurance companies a fee, based on premium volume, to file information in its centralized databases.

Conference of State Bank Supervisors (CSBS)

The CSBS is a national organization dedicated to advancing the U.S. dual banking system. Through the CSBS, state bank regulatory agencies and state-chartered banks support a system that offers chartering and supervision options. As an association, it works to optimize the authority of individual states to determine the activities of their financial institutions; represent the interests of the state banking system to federal and state legislative and regulatory agencies; enhance the professionalism of state banking departments and their personnel; and ensure that all banks continue to have the choice and flexibility of the state charter in the new era of financial modernization.

North American Securities Administrators Association (NASAA)

NASAA is a voluntary association whose membership in the United States consists of securities administrators in the 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. NASAA is the voice of state securities agencies responsible for efficient capital formation and grass-roots investor protection. NASAA members license firms and their agents, investigate violations of state and provincial law, file enforcement actions when appropriate, and educate the public about investment fraud.

Institutional Structure of the Regulators

The U.S. financial services system[3] is characterized as both a functional and a consolidated regulatory system, in which the following institutions have a role.

Federal Reserve System

The Board of Governors in Washington, D.C. and a network of 12 Federal Reserve Banks and their branches carry out a variety of system functions, including conducting and implementing monetary policy; overseeing a nationwide payments system; distributing the nation's currency and coin; supervising and regulating state member banks, bank holding companies, and financial holding companies (approximately 95 percent of all commercial banking activities); chartering *Edge Act* corporations; and serving as fiscal agent for the U.S. Treasury. The 12 Reserve Banks are each responsible for a particular geographic area or district of the United States. Besides carrying out functions for the System as a whole, such as administering nationwide banking and credit policies, each Reserve Bank acts as a depository for the banks in its own district and fulfills other district responsibilities.

The Federal Reserve System is considered to be an independent central bank, because its decisions do not have to be ratified by the President of the United States or anyone else in the executive or legislative branches of government. The System is, however, subject to oversight by the U.S. Congress. The Federal Reserve must work within the framework of the overall objectives of economic and financial policy established by Congress; therefore, the description of the System as "independent within the government" is more accurate.

The Board of Governors of the Federal Reserve System is a federal government agency, composed of seven members who are appointed by the President of the United States and confirmed by the U.S. Senate. The full term of a Board member is 14 years, and the appointments are staggered so that one term expires on January 31 of each even-numbered year. After serving a full term, a Board member may

[3] Budget and staffing numbers obtained from the Federal Reserve 2007 Budget Review.

not be reappointed. If a member leaves the Board before his or her term expires, however, the person appointed and confirmed to serve the remainder of the term may later be reappointed to a full term. The Chairman and the Vice Chairman of the Board are also appointed by the President and confirmed by the Senate. The nominees to these posts must already be members of the Board or must be simultaneously appointed to the Board. The terms for these positions are four years.

A major component of the Federal Reserve System is the Federal Open Market Committee, which is made up of the members of the Board of Governors, the president of the Federal Reserve Bank of New York, and presidents of four other Federal Reserve Banks, who serve on a rotating basis.

Each Reserve Bank has a board of nine directors, chosen from outside the Bank, as provided by law. The boards of the Reserve Banks are intended to represent a cross-section of banking, commercial, agricultural, industrial, and public interests within the Federal Reserve District. The directors, in turn, nominate a president and first vice president of the Reserve Bank, whose selection is subject to approval by the Board of Governors. Each branch of a Reserve Bank has its own board of directors composed of at least three and no more than seven members. A majority of these directors are appointed by the branch's Reserve Bank; the others are appointed by the Board of Governors.

The bank supervision and regulation function is by law the responsibility of the Board of Governors. The Board sets policy and direction and has delegated the day-to-day conduct of on-site examination and supervision to the Reserve Banks. The supervision function employs approximately 2,600 people and has an annual budget estimated at US$556 million. The major source of Federal Reserve Bank income is earnings from the portfolio of U.S. government securities in the System Open Market Account. Beginning with the 1998–99 budget, the Board of Governors has operated on a two-year budget cycle and a four-year planning cycle. Given their current business needs, the Federal Reserve Banks maintain an annual budget cycle.

Office of the Comptroller of the Currency (OCC)

The OCC is a bureau of the Department of the Treasury. In addition to its national headquarters in Washington, D.C., the OCC maintains district and field offices. Although the national headquarters sets policy and direction and oversees bank supervision, supervision of all but the largest national banks is coordinated through four district offices and 48 field offices located throughout the United States. The OCC currently supervises more than 1,700 national banks and about 50 federal branches of foreign banks (approximately two-thirds of all commercial banking assets). Legal and licensing staffs are based at the national headquarters and in the four district offices.

The OCC is led by the Comptroller, who is appointed by the President, with the advice and consent of the Senate, for a five-year term. The Comptroller also serves as a director of the Federal Deposit Insurance Corporation (FDIC).

The OCC has approximately 3,000 employees and has an annual budget of approximately US$637 million. The OCC is a nonappropriated federal agency funded through assessments and fees paid by the national banks it supervises. The OCC publishes an assessment and fee schedule at least annually in a bulletin entitled, "Notice of Comptroller of the Currency Fees."

Office of Thrift Supervision (OTS)

The OTS is also a bureau of the Department of Treasury. Its core mission is to supervise U.S. thrift institutions and their holding companies and ensure proper consumer protection. The OTS oversees domestic and international activities of the holding companies and affiliates that own these thrift institutions.

The Director of the OTS is appointed by the President and confirmed by the Senate for a five-year term. The OTS Director also serves as a member of the Board of Directors of the FDIC.

The OTS has approximately 950 employees and an estimated annual budget of US$233 million. It receives no appropriations from Congress; its operating budget is funded by periodic assessments of the thrift industry.

Federal Deposit Insurance Corporation (FDIC)

The FDIC directly examines and supervises about 5,250 banks and savings banks, more than half of the institutions in the banking system. It is the primary federal regulator of banks that are chartered by the states that do not join the Federal Reserve System. In addition, the FDIC has backup authority to examine the remaining insured banks and thrift institutions.

Under FDIC insurance, savings, checking, and other deposit accounts, when combined, are generally insured up to US$100,000 per depositor in each bank or thrift the FDIC insures. The FDIC generally provides separate coverage for retirement accounts, such as individual retirement accounts and Keoghs, insured up to US$250,000. The FDIC does not insure securities, mutual funds, or similar types of investments that banks and thrift institutions may offer.

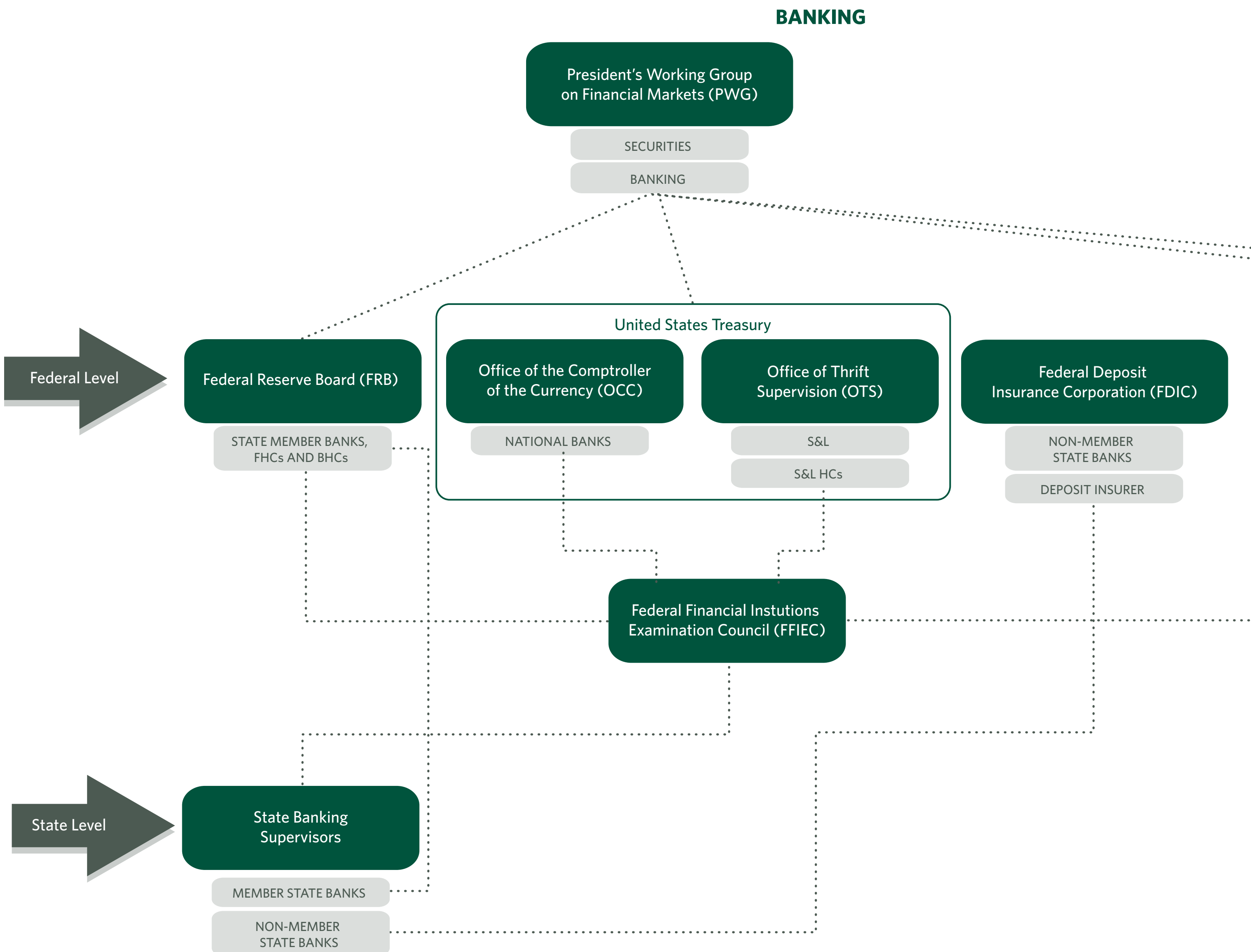
The FDIC is headquartered in Washington, D.C., but conducts much of its business in six regional offices and in field offices around the country. It is managed by a five-person Board of Directors, all of whom are appointed by the President and confirmed by the Senate, with no more than three being from the same political party.

The FDIC employs approximately 3,900 individuals and has an estimated annual budget of US$841 million. It receives no Congressional appropriations; it is funded by premiums that banks and thrift institutions pay for deposit insurance coverage, and from earnings on investments in U.S. Treasury securities. With an insurance fund totaling more than US$49 billion, the FDIC insures more than US$4.4 trillion of deposits in U.S. banks and thrifts.

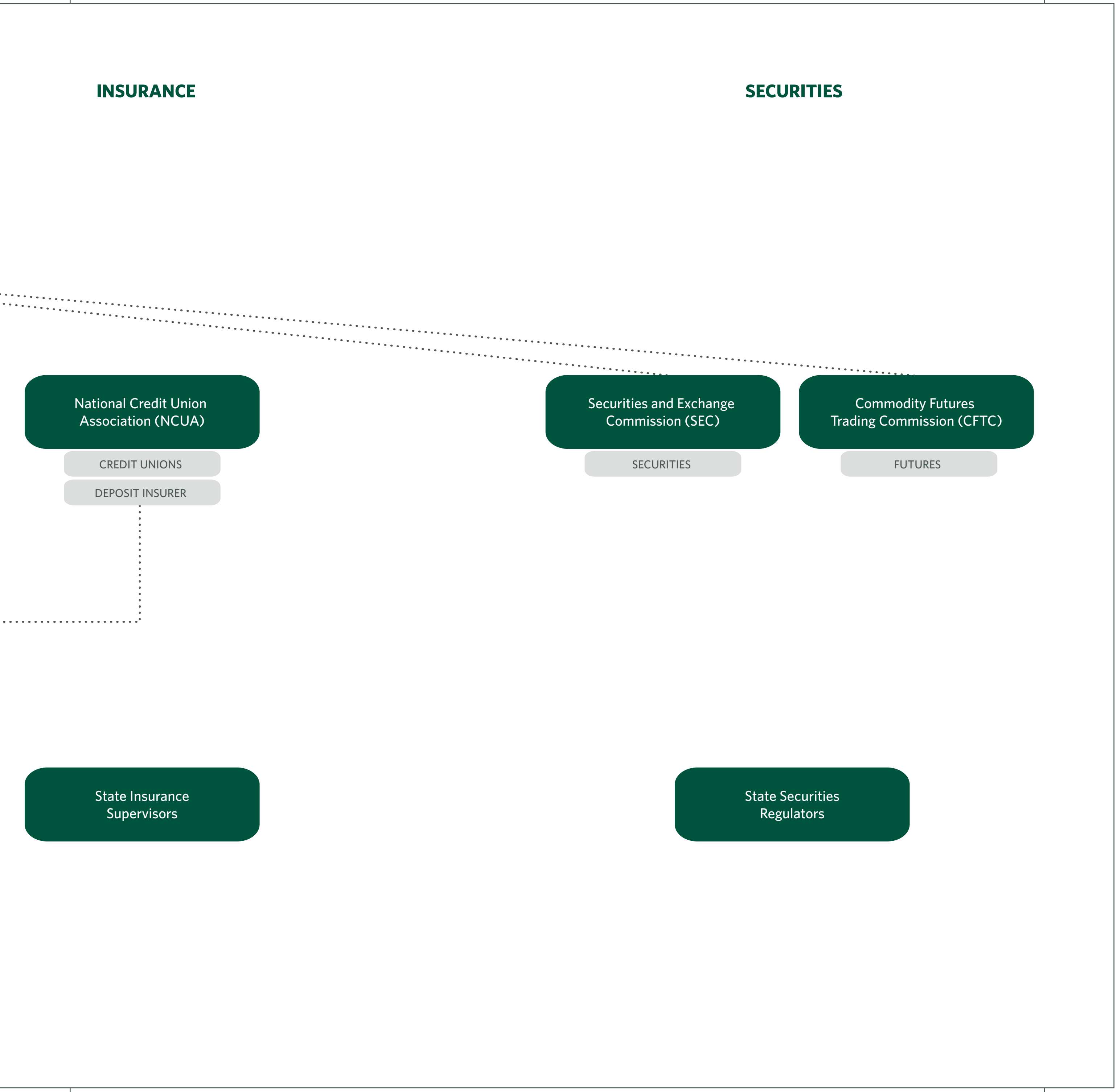
National Credit Union Administration (NCUA)

The National Credit Union Administration (NCUA) was formed to charter and supervise federal credit unions, and the National Credit Union Share Insurance Fund (NCUSIF) was formed to insure credit union deposits. The NCUSIF was created without tax dollars and is capitalized solely by credit unions. In 1979, a three-member board replaced the NCUA administrator. That same year, Congress created the Central Liquidity Facility, the credit union lender of last resort. There are federal- and state-chartered credit unions. At the state level, most are federally insured by the NCUSIF; however, there are about 185 state-chartered credit unions that are privately insured by American Share Insurance.

FIGURE 17. **The Financial Services System Regulatory Structure, United States**



BHC = Bank Holding Company.
FHC = Financial Holding Company.
S&L = Savings and Loan.
S&L HC = Savings and Loan Holding Company.
Note: Dotted lines indicate cooperative relationship.


INSURANCE
SECURITIES
National Credit Union Association (NCUA)
CREDIT UNIONS
DEPOSIT INSURER
Securities and Exchange Commission (SEC)
SECURITIES
Commodity Futures Trading Commission (CFTC)
FUTURES
State Insurance Supervisors
State Securities Regulators

The NCUA has a full-time, three-member board appointed by the President of the United States and confirmed by the Senate. No more than two board members can be from the same political party, and each member serves a staggered six-year term.

The NCUA has approximately 900 employees and an estimated annual budget of US$142 million. It receives no operating appropriations and is funded by federal credit union fees. The Central Liquidity Facility is a government corporation managed by the NCUA and owned by member credit unions. Created by Congress, the liquidity facility serves as a backup lender, meeting member liquidity needs when funds are unavailable from a standard credit source. The Community Development Revolving Loan Fund is the only appropriated funding NCUA receives.

Securities and Exchange Commission (SEC)

The mission of the SEC is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. It oversees the key participants in the securities world, including securities exchanges, securities brokers and dealers, investment advisors, and mutual funds. The SEC is concerned primarily with promoting the disclosure of important market-related information, maintaining fair dealing, and protecting against fraud.

The SEC supervises certain broker-dealer holding companies on a consolidated basis. In this capacity, supervision extends beyond the registered broker-dealer to the unregulated affiliates of the broker-dealer and the holding company itself. In supervising these Consolidated Supervised Entities (CSEs), the SEC focuses on the financial and operational condition of the group. The aim is to reduce the likelihood that weakness in the holding company or an unregulated affiliate endangers a regulated entity or the broader financial system. Like other consolidated supervisors overseeing internationally active institutions, the SEC requires CSEs to compute capital adequacy measures consistent with the Basel Standard.

The SEC consists of five presidentially appointed Commissioners, with staggered five-year terms. One of them is designated by the President as Chairman of the Commission. By law, no more than three of the Commissioners may belong to the same political party, ensuring nonpartisanship.

The Commission's approximately 3,800 staff are located in Washington, D.C. and in 11 regional offices around the country. The SEC has an estimated annual budget of US$830 million. It is funded by the fees it collects from the entities it regulates, subject to limits set by the congressional authorizations and appropriations processes.

Commodity Futures Trading Commission (CFTC)

Congress created the Commodity Futures Trading Commission (CFTC) in 1974 as an independent agency with the mandate to regulate commodity futures and option markets. The CFTC's mission is to protect market users and the public from fraud, manipulation, and abusive practices related to the sale of commodity and financial futures and options, and to foster open, competitive, and financially sound futures and option markets.

The CFTC organization consists of the Commission, the offices of the Chairman, and the agency's operating units. The Commission consists of five Commissioners appointed by the President, with the advice and consent of the Senate, to serve staggered five-year terms. The President designates one of the Commissioners as

Chairman. No more than three Commissioners at any one time may be from the same political party.

The CFTC has approximately 450 employees and an estimated annual budget of US$130 million. It receives an appropriation from the federal budget and must submit an annual budgetary request for such appropriation.

Insurance — State Commissioners

State legislatures set broad policy for the regulation of insurance. They establish and oversee state insurance departments, regularly review and revise state insurance laws, and approve regulatory budgets. State insurance departments, funded by each state, employ 12,500 regulatory personnel. Increases in staff and enhanced automation have allowed regulators to substantially boost the quality and intensity of their financial oversight of insurers and expand consumer protection activities. State regulation of insurance provides a major source of state revenue. In 2000, states collected more than US$10.4 billion in revenues from insurance sources. Of this amount, US$880 million—roughly 8.4 percent—went to regulate the business of insurance, and the remaining US$9.6 billion went to state general funds for other purposes.

Insurance is unique among financial services in that it is regulated by the states. The goals of insurance regulation articulated by most states include fair pricing of insurance, protecting insurance company solvency, preventing unfair practices by insurance companies, and ensuring availability of insurance coverage. For example, all states have the power to approve insurance rates; to periodically conduct financial examinations of insurers; to license companies, agents, and brokers; and to monitor and regulate claims handling. Each state has a department within the executive branch to regulate insurance. The head of the department is usually called the commissioner or director of insurance. A handful of states elect their insurance commissioner. In the remaining states, the insurance commissioner is appointed by the governor and serves at the governor's pleasure. The insurance department typically has broad, legislatively delegated powers to enforce state insurance laws, promulgate rules and regulations, and conduct hearings to resolve disputes.

Figure 17 provides a graphic depiction of the relationship among the above-mentioned institutions.

Enforcement

The banking supervisory agencies have broad enforcement powers over the institutions they supervise and over institution-affiliated parties. These may include actions in cases where institutions are undercapitalized, under prompt corrective action guidelines, or where institutions may be engaged in unsafe, unsound, or illegal practices. Supervisory and enforcement actions can take a number of forms, including formal actions such as cease and desist orders, and written agreements and informal steps such as MOUs, or verbal agreements (not considered an enforcement action), depending on the severity of the issues. Other actions include the removal, prohibition, or suspension of selected individuals, assessment of civil money penalties, and termination of insurance coverage, appointment of conservators, and divestment of activities.[4]

[4] For more information, see Section 5040.1 (Formal and Informal Corrective Actions) and 4133.1 (Prompt Corrective Action) of the Commercial Bank Examinations Manual, at www.federalreserve.gov/boarddocs/supmanual/cbem/200710/0710cbem.pdf; and Section 2110.0 of the Bank Holding Company Manual, at www.federalreserve.gov/boarddocs/supmanual/bhc/200707/bhc0707.pdf.

All federal supervisory agencies, and many of the state supervisory departments, have established ombudsman programs, which allow banks a process to appeal examination findings with which they disagree.

Among its enforcement powers, the SEC may seek a court injunction against acts and practices that deceive consumers or otherwise violate laws; suspend or revoke the registration or license of brokers, dealers, investment companies, and advisers that have violated laws; impose civil money penalties; issue cease and desist orders; refer persons to the Department of Justice for criminal prosecution in situations involving criminal fraud or other willful violation of laws; and bar attorneys, accountants, and other professionals from practicing before the Commission. In addition, many of the supervisory agencies have various legal powers of their own, including the power to subpoena witnesses, administer oaths, and compel the production of records anywhere in the United States.[5]

Framework for Domestic Coordination

The complex array of U.S. financial services system supervisory agencies requires a high degree of coordination, and supervisors have, over time, worked out processes for limiting overlap and enhancing resource efficiencies. These include arrangements between state and federal supervisors of state-chartered institutions, between holding companies and federally chartered bank subsidiaries, and between the Office of the Comptroller of the Currency (OCC) and the Federal Reserve System and the Federal Deposit Insurance Corporation (FDIC).

At a broader level, the congressionally authorized Federal Financial Institutions Examination Council (FFIEC) was established in March 1979, to serve as a forum for the various federal agencies (and later the Conference of State Bank Supervisors [CSBS]) to discuss issues of common concern and to seek consistency in their approaches to supervision and regulation. A formal interagency body, the FFIEC is empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions by federal supervisory agencies and to make recommendations to promote uniformity in the supervision of financial institutions.

The *Financial Institutions Reform, Recovery and Enforcement Act of 1989* (FIRREA) established the Appraisal Subcommittee within the Examination Council. State supervisors have also established coordinating bodies, such as the Conference of State Bank Supervisors (CSBS) for bank supervisors, and the National Association of Insurance Commissioners (NAIC) for insurance supervisors. U.S. financial authorities have been active in both international and bilateral forums to improve emergency communications with financial authorities in other jurisdictions.

U.S. regulators interact and cooperate with federal and state law enforcement in a number of ways. In fact, the regulators and law enforcement frequently have overlapping responsibility for investigations and enforcement actions on behalf of their respective agencies. In addition, referrals of matters are sometimes made from law enforcement to bank regulators, and vice-versa, as appropriate.

Leaders from each of the federal regulatory agencies are in regular contact with policymakers in government. They frequently testify before congressional com-

[5] For further details on broad areas of SEC enforcement, see the 2007 Annual Report online at www.sec.gov/about/secpar/secpar2007.pdf.

mittees on the economy, monetary policy, banking supervision and regulation, consumer credit protection, financial markets, and other matters. They also have regular contact with members of the President's Council of Economic Advisers and other key economic officials.

The major crisis-coordinating mechanism in the United States is the President's Working Group on Financial Markets (PWG), created in March 1988 following the October 1987 stock market crash. The PWG's mandate is to enhance interagency communication and coordination with respect to financial crises—including significant operational disruptions—in the U.S. financial system, and other areas where coordination may be appropriate. The PWG is chaired by the Secretary of the Treasury and includes the Chairmen of the Board of Governors of the Federal Reserve System, the Securities and Exchange Commission, and the Commodity Futures Trading Commission. The Secretary of the Treasury is a member of the President's cabinet and acts as a conduit for information sharing, as appropriate, and includes the Office of the Comptroller of the Currency, the Federal Reserve Bank of New York, and other market regulators in projects as appropriate. The PWG principals meet at least quarterly, and the agencies' staffs work closely on a number of ongoing projects affecting the financial sector, including preparedness for future financial or operational disruptions. The PWG agencies have established "duty officer" procedures to share information and coordinate responses at both the principal and staff levels in order to address potential financial and operational disruptions.

In addition, the PWG sponsors a broader interagency group known as the Financial and Banking Information Infrastructure Committee (FBIIC), which consists of the PWG agencies plus 12 additional federal and state financial regulatory agencies in the banking, securities, commodities, and insurance sectors. The FBIIC promotes interagency coordination in terms of preparations for and responses to natural and man-made threats to the U.S. financial sector infrastructure. The FBIIC has developed emergency communication protocols through a "duty officer" program and has established secure communication facilities for sharing classified information concerning financial and operational disruptions. FBIIC agencies work with the Department of Homeland Security and the National Communications System, as appropriate, in a crisis.

International Coordination

The U.S. participates in various international organizations. Please refer to the chart of international coordination activities and organizational participation on page 234.

Current Issues

The structure of U.S. financial services oversight has been the subject of significant debate and various analyses and proposals for many years,[6] involving

[6] The General Accountability Office, in particular, has published various reports on these issues, including:
March 1994: "Bank Regulation: Consolidation of the Regulatory Agencies"; GAO/T-GGD-94-106.
November 1996: "Bank Oversight Structure: U.S. and Foreign Experience May Offer Lessons for Modernizing U.S. Structure"; GAO/GGD-97-23.
October 2004: "Financial Regulation: Industry Changes Prompt Need to Reconsider U.S. Regulatory Structure"; GAO-05-61.
March 2007: "Financial Market Regulation: Agencies Engaged in Consolidated Supervision Can Strengthen Performance Measurement and Collaboration"; GAO-07-154.
October 2007: "Financial Regulation: Industry Trends Continue to Challenge the Federal Regulatory Structure," GAO-08-32.

issues such as streamlining the number of banking and thrift institution regulators, possible merger of the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC), creation of a federal insurance charter, and revised supervision of the Government-sponsored Enterprises (GSEs).[7] The issues have come into renewed focus more recently in discussions of the potential erosion of the competitiveness of U.S. financial markets, embodied in several recent reports, which have broadened the debate on structure to include such issues as principles vs. rules, and supervision vs. enforcement.[8] These issues will be the subject of further discussion in light of recent experience regarding the credit crisis, the distressed sale of Bear Stearns, the opening of the discount window to some securities firms, and the government support legislated for the GSEs.

The U.S. Treasury Department last year undertook a broad review of financial services regulation, and in March 2008, issued its "Blueprint for a Modernized Financial Regulatory Structure," setting forth the Administration's views on actions needed to update and modernize the U.S. financial institutions' regulatory framework. Treasury's proposal is not designed principally to solve the current problems in financial and credit markets. Rather, it is intended to ensure that the U.S. financial regulatory structure keeps pace with changes that have taken place in the U.S. and global financial systems. The proposal contains short-, intermediate-, and long-term recommendations.

The short-term recommendations include improvements in regulatory coordination and oversight. The Blueprint recommends creating a new federal commission for mortgage origination to better protect consumers. Intermediate-term recommendations focus on eliminating some of the duplication in the existing regulatory system, and offer ways to modernize the regulatory structure for certain financial services sectors, within the current framework. Recommendations include eliminating the thrift charter, creating an optional federal charter for insurance, and unifying oversight for futures and securities. The long-term recommendation is to create an entirely new regulatory structure using an objectives-based approach. The structure would consist of a market stability regulator, a prudential regulator, a business conduct regulator, with a focus on consumer protection, and a corporate finance regulator, with a focus on corporate disclosure and governance and accounting oversight.

While it is unlikely that major changes to the regulatory structure will be made by Congress in the near term, the Treasury's Blueprint is far-reaching. The fact that Treasury has put these proposals on the public agenda, together with the seriousness of current conditions, suggests that there will be an active debate in the period ahead about the need for modifications and enhancements to the U.S. financial regulatory system.

---

7 GSEs are privately held corporations with public purposes created by the U.S. Congress to reduce the cost of capital for certain borrowing sectors of the economy.

8 These include reports from the Committee on Capital Markets Regulation, the U.S. Chamber of Commerce, the Financial Services Roundtable, and the Bloomberg/Schumer Report.

The PWG's "Policy Statement on Financial Market Developments" identified five principal underlying causes of the current financial markets turmoil and highlighted the need for infrastructure changes in the OTC derivatives market to prevent problems in this area. The five principal causes identified were:

- A breakdown in underwriting standards at the mortgage origination level;
- Erosion of market discipline by those involved in the securitization process;
- Flaws in credit rating agencies' assessments of securitized assets;
- Risk management weaknesses at some large U.S. and European financial institutions; and
- Failure of regulatory policies, including capital and disclosure requirements, to mitigate risk management weaknesses.

The Statement includes 40 recommendations to improve market transparency and disclosure, risk awareness and risk management, capital and regulatory policies, practices regarding, and use of, credit ratings, and market infrastructure for over-the-counter derivatives products. The PWG will report in late 2008 on the progress made toward implementation of the recommendations.

Another issue that is being debated is the applicability of certain laws and regulations related to nonregulated or lightly regulated financial services providers. In addition, the debate considers the complexity of the U.S. regulatory structure and the impact of the complexity on the competitive status of U.S. financial entities.

ACRONYMS AND ABBREVIATIONS

BCCI	Bank of Credit and Commerce International
CFTC	Commodity Futures Trading Commission
CSBS	Conference of State Bank Supervisors
CSEs	Consolidated Supervised Entities
FASB	Financial Accounting Standards Board
FBIIC	Financial and Banking Information Infrastructure Committee
FDIC	Federal Deposit Insurance Corporation
FFIEC	Federal Financial Institutions Examination Council
FINRA	Financial Industry Regulatory Authority
GLBA	*Gramm-Leach-Bliley Act of 1999*
GSE	Government-sponsored Enterprise
ISDA	International Swaps and Derivatives Association
NAIC	National Association of Insurance Commissioners
NASD	National Association of Securities Dealers
NASDAQ	National Association of Securities Dealers Automated Quotation System
NCUA	National Credit Union Administration
NCUSIF	National Credit Union Share Insurance Fund
NYSE	New York Stock Exchange
OCC	Office of the Comptroller of the Currency
OTS	Office of Thrift Supervision
PCAOB	Public Company Accounting Oversight Board
PWG	President's Working Group on Financial Markets
SEC	Securities and Exchange Commission
SIFMA	Securities Industry and Financial Markets Association
SROs	Self-Regulatory Organizations

FINANCIAL CRISIS MANAGEMENT MECHANISMS

The European Union

EUROPEAN UNION

A number of crisis management mechanisms have been put in place by the European Union (EU). Many of them were implemented after the introduction of the euro in January 1999, when EU policymakers recognized that the advent of the euro significantly changed the landscape of the European financial system. The linkages among financial markets were strengthened, yet at the same time, the corresponding channels through which adverse financial market events on one market might impact another also increased. Safeguards were needed to mitigate the impact of cross-border financial events spreading rapidly throughout the EU.

In 2000 and 2001, the Council of the European Union's[1] Economic and Financial Committee (EFC)[2] addressed the existing crisis management structures by recommending a series of changes: cross-border cooperation and coordination; oversight of large financial groups and information exchange, both cross-border and cross-sector; and the development of agreements among EU member nations. The following are the main components of the EU financial crisis management system.

The Legislative Framework

Two EU directives,[3] the Capital Requirements Directive (CRD) and the Financial Conglomerate Directive (FCD), which were adopted as part of the EU's Financial Services Action Plan, address crisis management. The CRD (a) assigns a coordinating role to the authority responsible for the supervision of banking groups on a consolidated basis;[4] and (b) strengthens information-sharing requirements and procedures among supervisory agencies dealing with banking groups.[5] The FCD specifies the tasks to be carried out by the coordinating supervisor, including dissemination of information in normal (noncrisis) times and emergency situations, to other supervisors, national central banks, and the European Central Bank.

Memoranda of Understanding (MoUs)

There are four principal MoUs addressing financial crisis management in the European Union. The first MoU, adopted in 2001, addresses cooperation between banking supervisors and central banks in their capacity as payment systems overseers, dealing with the transmission of informa-

---

[1] The Council of the European Union consists of ministers from the national governments of all the EU countries. Meetings are attended by ministers responsible for the items to be discussed, for example, foreign ministers, ministers of the economy and finance (known as ECOFIN), ministers for agriculture, and so on, as appropriate.

[2] The EFC was established by the Treaty of Rome, signed in 1957, which created the European Community. The EFC advises the ECOFIN and the European Commission on financial stability matters. Membership in the EFC includes senior officials from the finance ministries, central banks, and supervisory committees of each EU country.

[3] National legislatures must pass laws to implement EU directives. Disputes over their correct implementation are addressed in the courts, and the European Court of Justice is the ultimate arbiter. European Regulations have what is known as "direct effect" across the Community and need no implementing legislation to have the force of law in all 27 member states of the European Union.

[4] Parent bank and parent supervisory authorities monitor the risk exposure of the banks or banking groups for which they are responsible and the adequacy of their capital on the basis of the totality of their business, wherever conducted.

[5] On crisis management matters, the CRD requires (a) the consolidated supervisor to alert central banks and ministries of finance as soon as practical in the event of an emergency that threatens the stability of the financial system of a member state, and (b) the competent supervisory authorities to cooperate closely and to share essential information. (Note: The CRD's provisions are being reviewed in light of the recent financial market turmoil. The European Commission, in fall 2008, may propose amendments to the CRD, including to the pertinent provisions on cooperation and exchange of information.)

tion in the event of liquidity or solvency problems. The second MoU, adopted in 2003, aims to ensure the early assessment of systemic crises (national and European) and sets out principles, procedures, and information requirements between EU banking supervisors and central banks. A third MoU was adopted by EU banking supervisors, central banks, and finance ministries in May 2005 on cooperation and information sharing in crisis management situations. In June 2008, the 2005 MoU was extended through the EU MoU on cross-border financial stability.[6] This MoU commits all signatories to cooperate across borders, in normal times, to ensure preparedness for the management of a potential cross-border crisis situation, and in crisis situations. It is designed to facilitate the management and resolution of cross-border systemic financial crises and seeks to facilitate private sector solutions, to minimize the economic and social costs, while promoting market discipline and limiting moral hazard.

The 2008 MoU extends the 2005 MoU in two ways. First, it includes common principles on cross-border crisis management, a common framework for assessing the systemic implications of a financial crisis, and common practical guidelines for crisis management. Second, considering the increasing interconnectedness among financial sectors, the securities market, insurance, and occupational pension supervisors joined the MoU, thereby acknowledging that the involvement of a broader range of authorities is necessary.

The Role of the European Central Bank (ECB)

The ECB's formal role in crisis management stems from its statutory tasks provided in the Treaty of Rome. The tasks relevant for crisis management include the conduct of monetary policy operations, ensuring the smooth functioning of payments and settlement systems, and contributing to financial stability.

The Role of National Central Banks (NCBs)

NCBs of the Eurosystem[7] are not only involved in crisis management mechanisms through their participation in EU policymaking and in various committees such as the EFC, but they also benefit from their Governors' membership in the Governing Council of the ECB. The Governing Council consists of six members of the Executive Board of the ECB and the Governors of the NCBs of the 15 Eurosystem countries.

NCBs have a particularly important role to play in the management of banking failures and financial crises. They can detect warning signs early and assess what channels are best to address unfolding events. In addition, they can provide emergency liquidity assistance or serve as lender of last resort to individual institutions. Emergency lending assistance remains the prerogative of the NCBs.

European Union Committees

European supervisors are interlinked via various committees and include the Banking Supervision Committee (BSC) and the

[6] The MoU of June 2008 has been signed by central banks, financial (not only banking) supervisory authorities, and finance ministries. The MoU includes 118 signatories from 27 Member States and the ECB. Following the MoU's implementation, other relevant authorities (for example, deposit insurance schemes and competition authorities), if in agreement, may sign the document.

[7] The Eurosystem comprises the ECB and the NCBs of the Member States that have adopted the euro. The Eurosystem is governed by the Governing Council and the Executive Board of the ECB.

Committee of European Banking Supervisors (CEBS).[8] These committees are meant to enhance cooperation and coordination among supervisors at various levels and on a number of different issues. They include supervisors from all countries in the EU and are not limited to Eurosystem member states.

Stress Testing

The EU authorities and the Eurosystem conduct stress testing and simulation exercises focusing on policy arrangements and contingency planning issues at the EU and euro-area levels. Testing has also taken place at the national and regional levels.

Notwithstanding the structures in place to enhance EU cooperation and coordination on matters related to financial crisis management, central bankers and supervisors continue to debate the procedures and structures for crisis prevention and crisis resolution, particularly those pertaining to cross-border banking and financial groups. One area for reform is deposit guarantee schemes. The European Commission and members states continue to discuss this issue.

ACRONYMS AND ABBREVIATIONS

BSC	Banking Supervision Committee
CEBS	Committee of European Banking Supervisors
CRD	Capital Requirements Directive
ECB	European Central Bank
ECOFIN	Economic and Financial Affairs Council
EFC	Economic and Financial Committee
EU	European Union
FCD	Financial Conglomerate Directive
NCBs	National central banks

[8] The CEBS includes representatives of central banks, the ECB, and other supervisory authorities. The ECB provides the secretariat to the BSC.

MEMBERSHIP IN INTERNATIONAL FINANCIAL INSTITUTIONS

Membership in international or multinational financial institutions is one method of developing codes of conduct, standards, and best practices. The institutions can facilitate cross-border coordination during normal times. The following matrix indicates the membership of the countries included in this report in a number of relevant international financial institutions. The institutions in the matrix address a variety of financial activities (for instance, banking, insurance, and securities), establish regional coordination, and bring together supervisors from various financial services disciplines, such as the Joint Forum and the Financial Stability Forum.

MEMBERSHIP OF INTERNATIONAL FINANCIAL INSTITUTIONS

	BCBS	CEBS	CEIOPS	CESR	CGFS
Australia					● [2]
Brazil					● [2]
Canada	●				●
China					● [2]
France	●	●	●	●	●
Germany	●	●	● [1]	●	●
Hong Kong					● [2]
Italy	●	●	●	●	●
Japan	●				●
Mexico					● [2]
The Netherlands	● [1]	●	●	●	●
Qatar					
Singapore					● [2]
Spain	●	●	●	●	● [2]
Switzerland	●				●
United Kingdom	●	●	●	●	●
United States	●				● [1]

[1] Chairman
[2] Associate Member
[3] President
[4] Vice Chairman
[5] Vice Chairman of the Executive Committee
[6] Vice Chairman of the Technical Committee
[7] Chairman of the Technical Committee

CPSS	FATF	FSF	IADI	IAIS	IOSCO	JF
	●	●		●	●	●
	●[3]		●	●	●	
●	●	●	●	●		●
	●			●	●[5]	
●	●	●	●	●	●	●
●	●	●		●	●	●
●	●	●	●	●	●	
●	●	●[1]		●	●	●
●	●	●	●	●	●	●
	●		●	●	●	
●	●	●		●	●[6]	●
	●[2]			●		
	●	●	●	●	●	
	●			●	●	●
●	●	●		●	●	●
●	●	●		●	●	●
●[1]	●	●	●	●[4]	●[7]	●[1]

BCBS: Basel Committee on Banking Supervision
CEBS: Committee of European Banking Supervisors
CEIOPS: Committee of European Insurance and Occupational Pensions Supervisors
CESR: Committee of European Securities Regulators
CGFS: Committee on the Global Financial System
CPSS: Committee on Payment and Settlement Systems
FATF: Financial Action Task Force
FSF: Financial Stability Forum
IADI: International Assocation of Deposit Insurers
IAIS: International Assocation of Insurance Supervisors
IOSCO: International Organization of Securities Commissions
JF: Joint Forum

APPENDIX

SUPPORTING INSTITUTIONS

The G30 would like to thank the many institutions and individuals who contributed their input and insights and helped make this study a success. We would particularly like to thank the following institutions for their support.

Australia

Reserve Bank of Australia
Australian Prudential Regulation Authority
Australian Securities and Investments Commission
Commonwealth Bank of Australia

Brazil

Banco Central do Brasil

Canada

Department of Finance
Bank of Canada
Office of the Superintendent of Financial Institutions

China

The People's Bank of China
China Banking Regulatory Commission
China Securities Regulatory Commission
Chinese Insurance Regulatory Commission

European Union

European Central Bank

France

Banque de France
Commission Bancaire
Autorité de Marchés Financiers
BNP Paribas

Germany

German Federal Ministry of Finance
Deutsche Bundesbank
Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)
Bundesverband Deutscher Banken
Deutscher Sparkassen- und Giroverband

Hong Kong

The Hong Kong Monetary Authority

Italy

The Ministry of Economy and Finance
Banca d'Italia

Japan

Bank of Japan
Financial Services Agency

Mexico

Secretaría de Hacienda y Crédito Público
Banco de México
Comisión Nacional Bancaria y de Valores
Comisión Nacional de Seguros y Fianzas
Instituto para la Protección al Ahorro Bancario
Comisión Nacional del Sistema de Ahorro para el Retiro
Comisión Nacional para la Defensa de los Usuarios de las Instituciones Financieras
Asociación de Bancos de México

The Netherlands
Ministry of Finance
De Nederlandsche Bank
Autoriteit Financiële Markten

Qatar
Qatar Financial Centre
Regulatory Authority

Singapore
The Monetary Authority of Singapore
Bank of America, Asia
Bank of Singapore
Temasek Holdings (Private) Limited

Spain
Ministry of Economy and Finance
Banco de España
Comisión Nacional del Mercado de Valores
Dirección General de Seguros y Fondos de Pensiones
Asociación Española de Banca
Bolsas y Mercados Españoles

Switzerland
Federal Finance Administration
Swiss National Bank
Swiss Federal Banking Commission
Zurich Financial Services

United Kingdom
Her Majesty's Treasury
Financial Services Authority
Bank of England
British Bankers Association
Morgan Stanley & Co., International, Ltd.

United States
U.S. Department of the Treasury
The Board of Governors of the Federal Reserve System
Federal Reserve Bank of New York
Federal Deposit Insurance Corporation
Office of the Comptroller of the Currency
Securities and Exchange Commission
National Association of Insurance Commissioners
U.S. Commodity Futures Trading Commission
New York State Banking Department
The Financial Industry Regulatory Authority
The Securities Industry and Financial Markets Association
American Bankers Association
Promontory Capital

International Institutions
Financial Stability Forum, Bank for International Settlements
International Monetary Fund

Note: Deloitte & Touche LLC provided support in all 17 markets surveyed.

GROUP OF THIRTY MEMBERS

Paul A. Volcker
Chairman of the Board of Trustees, Group of Thirty
Former Chairman, Board of Governors of the Federal Reserve System

Jacob A. Frenkel
Chairman, Group of Thirty
Vice Chairman, American International Group
Former Governor, Bank of Israel

Geoffrey L. Bell
Executive Secretary, Group of Thirty
President, Geoffrey Bell & Company, Inc.

Montek S. Ahluwalia
Deputy Chairman, Planning Commission of India
Former Director, Independent Evaluation Office, International Monetary Fund

Abdulatif Al-Hamad
Chairman, Arab Fund for Economic and Social Development
Former Minister of Finance and Minister of Planning, Kuwait

Leszek Balcerowicz
Chairman of the Board, Bruegel
Former President, National Bank of Poland
Former Deputy Prime Minister and Minister of Finance, Poland

Jaime Caruana
Counsellor and Director, MCM Department, International Monetary Fund
Former Governor, Banco de España
Former Chairman, Basel Committee on Banking Supervision

Domingo Cavallo
Chairman and CEO, DFC Associates, LLC
Former Minister of Economy, Argentina

E. Gerald Corrigan
Managing Director, Goldman Sachs & Co.
Former President, Federal Reserve Bank of New York

Andrew D. Crockett
President, JPMorgan Chase International
Former General Manager, Bank for International Settlements

Guillermo de la Dehesa Romero
Director and Member of the Executive Committee, Grupo Santander
Former Deputy Managing Director, Banco de España
Former Secretary of State, Ministry of Economy and Finance, Spain

Mario Draghi
Governor, Banca d'Italia
Chairman, Financial Stability Forum
Member of the Governing and General Councils, European Central Bank
Former Vice Chairman and Managing Director, Goldman Sachs International

Martin Feldstein
President Emeritus, National Bureau of Economic Research
Former Chairman, Council of Economic Advisers

Roger W. Ferguson, Jr.
Chief Executive, TIAA-CREF
Former Chairman, Swiss Re America Holding Corporation
Former Vice Chairman, Board of Governors of the Federal Reserve System

Stanley Fischer
Governor, Bank of Israel
Former First Managing Director, International Monetary Fund

Arminio Fraga Neto
Partner, Gavea Investimentos
Former Governor, Banco do Brasil

Timothy F. Geithner
President and Chief Executive Officer, Federal Reserve Bank of New York
Former U.S. Undersecretary of Treasury for International Affairs

Gerd Häusler
Managing Director and Member of the Advisory Board, Lazard & Co
Former Counsellor and Director, International Capital Markets Department, International Monetary Fund
Former Managing Director, Dresdner Bank

Philipp Hildebrand
Vice Chairman of the Governing Board, Swiss National Bank
Former Partner, Moore Capital Management

Mervyn King
Governor, Bank of England
Former Professor of Economics, London School of Economics

Paul Krugman
Professor of Economics, Woodrow Wilson School, Princeton University
Former Member, Council of Economic Advisors

Guillermo Ortiz Martinez
Governor, Banco de Mexico
Former Secretary of Finance and Public Credit, Mexico

Tommaso Padoa-Schioppa
Former Minister of Economy and Finance, Italy
Chairman, International Accounting Standards Committee
Former Member of the Executive Board, European Central Bank
Former Chairman, CONSOB

Kenneth Rogoff
Thomas D. Cabot Professor of Public Policy and Economics, Harvard University
Former Chief Economist and Director of Research, IMF

Tharman Shanmugaratnam
Minister of Finance, Singapore
Former Managing Director, Monetary Authority of Singapore

Lawrence Summers
Charles W. Eliot University Professor, Harvard University
Former President, Harvard University
Former U.S. Secretary of the Treasury

Jean-Claude Trichet
President, European Central Bank
Former Governor, Banque de France

David Walker
Senior Advisor, Morgan Stanley International, Inc.
Former Chairman, Morgan Stanley International, Inc.
Former Chairman, Securities and Investments Board, UK

Zhou Xiaochuan
Governor, People's Bank of China
Former President, China Construction Bank
Former Asst. Minister of Foreign Trade

Yutaka Yamaguchi
Former Deputy Governor, Bank of Japan
Former Chairman, Euro Currency Standing Commission

Ernesto Zedillo
Director, Yale Center for the Study of Globalization, Yale University
Former President of Mexico

SENIOR MEMBERS

William McDonough
Vice Chairman and Special Advisor to the Chairman, Merrill Lynch
Former Chairman, Public Company Accounting
Oversight Board
Former President, Federal Reserve Bank of New York

William R. Rhodes
Senior Vice Chairman, Citigroup
Chairman, President and CEO, Citicorp and Citibank

Ernest Stern
Partner and Senior Advisor, The Rohatyn Group
Former Managing Director, JPMorgan Chase
Former Managing Director, World Bank

Marina v N. Whitman
Professor of Business Administration & Public Policy, University of Michigan
Former Member, Council of Economic Advisors

EMERITUS MEMBERS

Lord Richardson of Duntisbourne, KG
Honorary Chairman, Group of Thirty
Former Governor, Bank of England

Richard A. Debs
Advisory Director, Morgan Stanley & Co.

Gerhard Fels
Former Director, Institut der deutschen Wirtschaft

Wilfried Guth
Former Spokesmen of the Board of Managing Directors, Deutsche Bank AG

Toyoo Gyohten
President, Institute for International Monetary Affairs
Former Chairman, Bank of Tokyo

John G. Heimann
Senior Advisor, Financial Stability Institute
Former US Comptroller of the Currency

Erik Hoffmeyer
Former Chairman, Danmarks Nationalbank

Peter B. Kenen
Senior Fellow in International Economics, Council on Foreign Relations
Former Walker Professor of Economics & International Finance,
Department of Economics, Princeton University

Jacques de Larosière
Conseiller, BNP Paribas
Former President, European Bank for Reconstruction and Development
Former Managing Director, International Monetary Fund
Former Governor, Banque de France

Shijuro Ogata
Former Deputy Governor, Bank of Japan
Former Deputy Governor, Japan Development Bank

Sylvia Ostry
Distinguished Research Fellow Munk Centre for International Studies, Toronto
Former Ambassador for Trade Negotiations, Canada
Former Head, OECD Economics and Statistics Department

GROUP OF THIRTY PUBLICATIONS SINCE 1990

REPORTS

Sharing the Gains from Trade: Reviving the Doha Round
Study Group Report. 2004

Key Issues in Sovereign Debt Restructuring
Study Group Report. 2002

Reducing the Risks of International Insolvency
A Compendium of Work in Progress. 2000

Collapse: The Venezuelan Banking Crisis of '94
Ruth de Krivoy. 2000

The Evolving Corporation: Global Imperatives and National Responses
Study Group Report. 1999

International Insolvencies in the Financial Sector
Study Group Report. 1998

Global Institutions, National Supervision and Systemic Risk
Study Group on Supervision and Regulation. 1997

Latin American Capital Flows: Living with Volatility
Latin American Capital Flows Study Group. 1994

Defining the Roles of Accountants, Bankers and Regulators in the United States
Study Group on Accountants, Bankers and Regulators. 1994

EMU After Maastricht
Peter B. Kenen. 1992

Sea Changes in Latin America
Pedro Aspe, Andres Bianchi and Domingo Cavallo,
with discussion by S.T. Beza and William Rhodes. 1992

The Summit Process and Collective Security: Future Responsibility Sharing
The Summit Reform Study Group. 1991

Financing Eastern Europe
Richard A. Debs, Harvey Shapiro and Charles Taylor. 1991

The Risks Facing the World Economy
The Risks Facing the World Economy Study Group. 1991

THE WILLIAM TAYLOR MEMORIAL LECTURES

Two Cheers for Financial Stability
Howard Davies. 2006

Implications of Basel II for Emerging Market Countries
Stanley Fisher. 2003

Issues in Corporate Governance
William J. McDonough. 2003

Post Crisis Asia: The Way Forward
Lee Hsien Loong. 2001

Licensing Banks: Still Necessary?
Tommaso Padoa-Schioppa. 2000

Banking Supervision and Financial Stability
Andrew Crockett. 1998

Global Risk Management
Ulrich Cartellieri and Alan Greenspan. 1996

The Financial Disruptions of the 1980s: A Central Banker Looks Back
E. Gerald Corrigan. 1993

SPECIAL REPORTS

Global Clearing and Settlement: Final Monitoring Report
Global Monitoring Committee. 2006

Reinsurance and International Financial Markets
Reinsurance Study Group. 2006

Enhancing Public Confidence in Financial Reporting
Steering & Working Committees on Accounting. 2004

Global Clearing and Settlement: A Plan of Action
Steering & Working Committees of Global Clearing & Settlements Study. 2003

Derivatives: Practices and Principles: Follow-up Surveys of Industry Practice
Global Derivatives Study Group. 1994

Derivatives: Practices and Principles, Appendix III: Survey of Industry Practice
Global Derivatives Study Group. 1994

Derivatives: Practices and Principles, Appendix II: Legal Enforceability: Survey of Nine Jurisdictions
Global Derivatives Study Group. 1993

Derivatives: Practices and Principles, Appendix I: Working Papers
Global Derivatives Study Group. 1993

Derivatives: Practices and Principles
Global Derivatives Study Group. 1993

Clearance and Settlement Systems: Status Reports, Autumn 1992
Various Authors. 1992

Clearance and Settlement Systems: Status Reports, Year-End 1990
Various Authors. 1991

Conference on Clearance and Settlement Systems; London, March 1990: Speeches
Various Authors. 1990

Clearance and Settlement Systems: Status Reports, Spring 1990
Various Authors. 1990

OCCASIONAL PAPERS

77. Distorting the Micro to Embellish the Macro: The Case of Argentina
Domingo Cavallo, Joaquín Cottani, 2008

76. Credit Crunch: Where Do We Stand?
Thomas A. Russo, 2008

75. Banking, Financial, and Regulatory Reform
Liu Mingkang, Roger Ferguson, Guillermo Ortiz Martinez. 2007

74. The Achievements and Challenges of European Union Financial Integration and Its Implications for the United States
Jacques de Larosiere. 2007

73. Nine Common Misconceptions About Competitiveness and Globalization
Guillermo de la Dehesa. 2007

72. International Currencies and National Monetary Policies
Barry Eichengreen. 2006

71. The International Role of the Dollar and Trade Balance Adjustment
Linda Goldberg and Cédric Tille. 2006

70. The Critical Mission of the European Stability and Growth Pact
Jacques de Larosiere. 2004

69. Is It Possible to Preserve the European Social Model?
Guillermo de la Dehesa. 2004

68. External Transparency in Trade Policy
Sylvia Ostry. 2004

67. American Capitalism and Global Convergence
Marina v. N. Whitman. 2003

66. Enron et al: Market Forces in Disarray
Jaime Caruana, Andrew Crockett, Douglas Flint, Trevor Harris, Tom Jones. 2002

65. Venture Capital in the United States and Europe
Guillermo de la Dehesa. 2002

64. Explaining the Euro to a Washington Audience
Tommaso Padoa-Schioppa. 2001

63. Exchange Rate Regimes: Some Lessons from Postwar Europe
Charles Wyplosz. 2000

62. Decisionmaking for European Economic and Monetary Union
Erik Hoffmeyer. 2000

61. Charting a Course for the Multilateral Trading System: The Seattle Ministerial Meeting and Beyond
Ernest Preeg. 1999

60. Exchange Rate Arrangements for the Emerging Market Economies
Felipe Larraín and Andrés Velasco. 1999

59. G3 Exchange Rate Relationships:
A Recap of the Record and a Review of Proposals for Change
Richard Clarida. 1999

58. Real Estate Booms and Banking Busts: An International Perspective
Richard Herring and Susan Wachter. 1999

57. The Future of Global Financial Regulation
Sir Andrew Large. 1998

56. Reinforcing the WTO
Sylvia Ostry. 1998

55. Japan: The Road to Recovery
Akio Mikuni. 1998

54. Financial Services in the Uruguay Round and the WTO
Sydney J. Key. 1997

53. A New Regime for Foreign Direct Investment
Sylvia Ostry. 1997

52. Derivatives and Monetary Policy
Gerd Hausler. 1996

51. The Reform of Wholesale Payment Systems and Impact on Financial Markets
David Folkerts-Landau, Peter Garber, and Dirk Schoenmaker. 1996

50. EMU Prospects
Guillermo de la Dehesa and Peter B. Kenen. 1995

49. New Dimensions of Market Access
Sylvia Ostry. 1995

48. Thirty Years in Central Banking
Erik Hoffmeyer. 1994

47. Capital, Asset Risk and Bank Failure
Linda M. Hooks. 1994

46. In Search of a Level Playing Field: The Implementation of the Basle Capital Accord in Japan and the United States
Hal S. Scott and Shinsaku Iwahara. 1994

45. The Impact of Trade on OECD Labor Markets
Robert Z. Lawrence. 1994

44. Global Derivatives: Public Sector Responses
James A. Leach, William J. McDonough, David W. Mullins, Brian Quinn. 1993

43. The Ten Commandments of Systemic Reform
Vaclav Klaus. 1993

42. Tripolarism: Regional and Global Economic Cooperation
Tommaso Padoa-Schioppa. 1993

41. The Threat of Managed Trade to Transforming Economies
Sylvia Ostry. 1993

40. The New Trade Agenda
Geza Feketekuty. 1992

39. EMU and the Regions
Guillermo de la Dehesa and Paul Krugman. 1992

38. Why Now? Change and Turmoil in U.S. Banking
Lawrence J. White. 1992

37. Are Foreign-owned Subsidiaries Good for the United States?
Raymond Vernon. 1992

36. The Economic Transformation of East Germany: Some Preliminary Lessons
Gerhard Fels and Claus Schnabel. 1991

35. International Trade in Banking Services: A Conceptual Framework
Sydney J. Key and Hal S. Scott. 1991

34. Privatization in Eastern and Central Europe
Guillermo de la Dehesa. 1991

33. Foreign Direct Investment: The Neglected Twin of Trade
DeAnne Julius. 1991

32. Interdependence of Capital Markets and Policy Implications
Stephen H. Axilrod. 1990

31. Two Views of German Reunification
Hans Tietmeyer and Wilfried Guth. 1990

30. Europe in the Nineties: Problems and Aspirations
Wilfried Guth. 1990

29. Implications of Increasing Corporate Indebtedness for Monetary Policy
Benjamin M. Friedman. 1990

28. Financial and Monetary Integration in Europe: 1990, 1992 and Beyond
Tommaso Padoa-Schioppa. 1990

Group of Thirty
1726 M Street, N.W., Suite200
Washington, DC 20036
ISBN 1-56708-142-8