



The London G20 Summit

AGREED CHANGES TO THE REGULATION OF THE FINANCIAL SYSTEM

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Introduction

The G20 Summit in London on 2 April 2009 agreed on a number of matters concerning changes to the regulation of the financial system. Some of these are re-statements of decisions taken at the G20 Summit in Washington DC in November 2008, sometimes with additional details and timelines. Others reflect decisions taken and initiatives launched in the intervening period, or confirm an emerging consensus already apparent from recent public and private sector publications. But although there is little that is entirely new, there is no doubt that the concentrating effect of the London Summit has been instrumental in enabling substantial progress to be made.

Financial Stability Board

The G20 agreed to re-establish the Financial Stability Forum (FSF) with a 'broadened mandate to promote financial stability'. It is being renamed as the 'Financial Stability Board' (FSB). A decision was made last month to expand its membership to include all G20 countries, Spain and the European Commission.

The mandate of the FSF until now has been:

- to assess vulnerabilities affecting the international financial system and to identify and oversee action needed to address these; and
- to improve co-ordination and information exchange among the various authorities responsible for financial stability.

The FSB's mandate will include the following additional tasks:

- to monitor and advise on market developments and their implications for regulatory policy;
- to advise on and monitor best practice in meeting regulatory standards;
- to undertake joint strategic reviews of the policy development work of the international standard-setting bodies to ensure their work is timely, co-ordinated, focused on priorities, and that it addresses gaps;
- to set guidelines for and support the establishment and operation of supervisory colleges, including through identification of the most systemically important cross-border firms;
- to support contingency planning for cross-border crisis management, particularly with respect to systemically important firms; and
- to collaborate with the International Monetary Fund (IMF) to conduct 'early warning' exercises to identify the build-up of macroeconomic and financial risks and the actions needed to deal with them.

Members of the FSB have committed to pursue the maintenance of financial stability, maintain the openness of the financial sector, and endorse and implement international financial standards (including 12 key international standards and codes). They have also agreed to undergo periodic peer reviews.

All these changes are incremental rather than revolutionary but they are nonetheless significant. The Turner Review has pointed to the existence of global

finance without global governance as a fundamental fault-line in the current financial system. The establishment of the FSB seeks to ease this tension by taking a small step in the direction of global governance. The change should not be overstated: although the FSB is no longer a mere 'forum', it is not gaining decision-making powers. Nevertheless, it is clear that the FSB will be the primary global body through which governments will work towards global co-ordination in regulatory matters and, of course, it is possible that its role may evolve over time.

International co-operation

The G20 has reiterated commitments made in the November Summit to establish supervisory colleges for those significant cross-border firms for which such colleges do not already exist. While the Washington Summit envisaged that this would have been completed by 31 March 2009, a new deadline of June 2009 has now been set.

On the day of the London Summit, the FSB published a set of high-level principles for cross-border co-operation on crisis management. The G20 has committed to implement these immediately. The IMF and the FSB have agreed to work together to launch an initial early warning exercise in spring 2009.

Prudential regulation

On capital adequacy, the G20 confirmed the consensus that has been emerging since the Washington Summit that a system of 'capital buffers' should be implemented: capital requirements should vary through the cycle, being higher in good times so that they can absorb losses and fall to lower levels in bad times. The Basel Committee on Banking Supervision (BCBS) has been asked to produce recommendations on minimum levels of capital in 2010. Guidelines for harmonising the definition of capital are also to be produced by the end of 2009 and implemented as soon as possible. The FSB published a report on addressing pro-cyclicality in the financial system on the day of the London Summit, and the FSB and other bodies have been asked to take forward the implementation of these proposals.

The G20 also came out in favour of a simple, internationally comparable, leverage ratio limit, to

supplement the more sophisticated Basel II risk-weighted assets ratio.

On securitisation, the BCBS and national authorities have been asked to take forward work on improving incentives for better risk management, including quantitative retention requirements, by 2010.

On liquidity, the G20 called on the BCBS and national authorities to agree by 2010 a global framework for promoting stronger liquidity buffers. No timeline is given for implementation of such a framework. It will be interesting to see how the Financial Services Authority (FSA) will proceed with its own December 2008 liquidity proposals, in view of the prospect of global co-ordination on this issue.

Scope of regulation

The G20 restated the general principle that all systemically important financial institutions, markets and instruments should be subject to an appropriate degree of regulation and oversight. The IMF and FSB are to produce guidelines on the assessment of 'systemic importance' for this purpose by autumn 2009. The boundaries of regulation will be kept under review and there will be an attempt to ensure consistent approaches at international level.

Regarding hedge funds specifically, the G20 seems to have gone somewhat further than the proposals of the Turner Review. The G20 has agreed that hedge funds or their managers should be required to be registered (possibly subject to a minimum size requirement) and to disclose information necessary to assess their systemic risk. In addition, they will be subject to oversight to ensure that they have adequate risk management. On the face of it, a power to ensure 'adequate risk management' would not amount to a power to specify which risks may or may not be undertaken, but there may be scope for different interpretations here. National authorities are called on to work through the FSB to implement these principles by the end of 2009. Supervisors should ensure that institutions that have hedge funds as their counterparties have effective risk management, including mechanisms to monitor their leverage and set limits for single counterparty exposures.

There is a specific commitment to promote standardisation and resilience of credit derivatives

markets, in particular through the establishment of central clearing counterparties. The industry is called on to develop an action plan for standardisation by autumn 2009.

Remuneration

On the day of the London Summit the FSF published a set of 'Principles for Sound Compensation Practices', on remuneration practices in financial institutions. G20 members have committed to implement these by autumn 2009. These principles have many similarities with the draft code of practice on this subject published by the FSA last month. Areas of overlap include the role of the board of directors in the design and operation of remuneration structures and a requirement for the timing and amount of payments to reflect both longer- and shorter-term risks. An additional element in the FSF principles is that firms should disclose clear, comprehensive and timely information about remuneration practices – not just for top-level executives but also for employees lower down the corporate hierarchy.

Tax havens and non-co-operative jurisdictions

The G20 has called on all countries to adopt the Organisation for Economic Co-operation and Development (OECD) standard for information exchange on tax reflected in the UN Model Tax Convention. The G20 notes that the OECD has published a list of countries assessed by the Global Forum against the international standard for the exchange of information, and lists potential counter-measures for countries to consider.

The G20 has also asked the FSB and the IMF to co-operate with international standard-setters to assess implementation by relevant jurisdictions of prudential standards of regulation and to develop a toolbox to promote adherence. The Financial Action Task Force has been asked to reinvigorate the process for assessing compliance with anti money laundering and counter-terrorist financing.

Accounting

The G20 has reaffirmed the framework of fair-value accounting in general terms. This is somewhat balanced,

however, by agreement that accounting standard-setters should 'improve standards for the valuation of financial instruments based on their liquidity and investors' holding horizons' and that progress needs to be made in a number of specified areas.

Credit rating agencies

The G20 commitments on credit rating agencies (CRAs) are little changed from those made at the Washington Summit. All CRAs whose ratings are to be used for regulatory purposes will be subject to a regulatory oversight regime that includes registration, to be established by the end of 2009. Specific required elements of the regime are specified. This regime is to be consistent across jurisdictions and the International Organization of Securities Commission (IOSCO) is given a co-ordinating role in this respect. The BCBS is encouraged to take forward its own review on the use of CRA ratings in prudential regulation.

Next steps

The FSB and IMF are asked to monitor progress on these decisions and to provide a report to the next meeting of G20 Finance Ministers and Central Bank Governors.

Conclusion

The list of agreed actions indicates a substantial degree of international consensus on the way forward. The FSA will no doubt be satisfied that there is little here that is inconsistent with the proposals in the Turner Review. It will be interesting to see whether this G20 statement is now regarded as defining the agenda for the future or if other significant proposals may still be considered. Some authorities and commentators seem keen to keep the boundaries of the debate open, so that ideas such as the separation of 'utility banking' from 'investment banking' or specific measures to address the particular risks posed by very large cross-border groups can continue to be heard.

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