



***WSBI contribution to the G20 work
on Financial markets and the world economy
London Summit, 2 April 2009***

The members of the World Savings Banks Institute (WSBI) are savings and socially committed retail banks that offer their services mainly to private clients, small and medium sized enterprises and local authorities, work through extensive distribution networks that enable them to develop proximity services and provide regional outreach, and a socially responsible approach to business and to society. The 109 WSBI members, representing 7 000 banking institutions, are active in 92 countries throughout the world, in developing and developed countries alike. Assets of WSBI members active in the G20 countries amount to 11.044.348,03 million USD and non-bank deposits to 6.531.594,21 million USD¹.

In the perspective of the 2 April 2009 London Summit, where important decisions will be made to address the global financial crisis, the WSBI and its members would like to call the attention of the G20 members on a number of concerns and proposals, as their contribution to the work of the Group.

1. Defining a global response to be adapted to local contexts

For WSBI, the current crisis calls for responses at several levels. First, it requires short-term measures with a view to stabilise markets and support economic recovery, as well as a long-term programme to reform the international financial system and prevent such market disruptions to happen again. The timing of these responses is an important issue: while the effects of the crisis need rapid treatment, the deeper causes should not be addressed through hasty measures, but through thoroughly worked-out solutions involving all stakeholders.

A global response is required and will be driven by the decisions made by the G20. It is crucial indeed that the strategic orientations are defined at this global level, for a coordinated and consistent reaction of all markets and to maximise the effects of the solutions developed. However, it is also critical to keep in mind that these global guidelines will need to be tailored and adapted at regional and national level, to best fit market realities which, although developing in a globalised environment, still have their specificities as far as financial market structures, business culture and activities are concerned. While the crisis is global in scope, some of its effects are strongly linked to the particular economic or banking structures of a given country and this needs to be taken into account for efficient solutions.

¹ See full list of G 20 members and figures as an Annex





2. Valuing key elements for the development of stable and sustainable financial markets

WSBI and its member banks would like to underline that a real understanding of the effects and developments relating to the crisis is conditional on distinguishing between the different market players and their activities. Any generalisation may blur – and probably distort - the lessons which can be learnt from the current events, and, worse, bias the remedies which will be proposed for them, thereby reducing their potential to improve the situation or even render them harmful and counterproductive. The merits of what worked well need to be recognized without discrediting all existing process and structures.

In this respect, WSBI would like to emphasise that:

- while some players, led by the ultimate objective to maximize short term gains, got trapped by sophisticated capital market products, other banking institutions, such as WSBI member banks, put innovation to the service of their core market segment, retail customers and small businesses. They developed their long-standing intermediation activity between deposit-taking and credit activities, acting as engines of growth for local markets and supporting the real economy. This business model, based on a close relationship with retail customers and a sound knowledge of their needs and capacities, leads to a long-term vision and greatly reduces the impact of the volatility of financial markets on the solvency and liquidity of the institution. Confidence of customers, illustrated by the massive inflow of deposits at many WSBI member banks over the last months, results from this stabilising function. *The benefits and role of socially committed retail banks, supporting local economic and social development and organised along a stakeholder business model, therefore needs to be highlighted as a central component of balanced and efficient banking markets;*
- the diversity of financial sector providers, with different business models, scopes and sizes, is a key asset to stimulate market innovation and healthy competition, for the benefit of financial services end-users. Besides, in the current context, the coexistence of different banking structures has so far helped contain the risk of extension of the financial crisis. If it was not for the diversity of market players and business models, which prevented a situation where all market players are affected with the same severity, this crisis could indeed have grown to be unmanageable. *It is therefore essential to recognise the key role of pluralistic banking structures for the stability, sustainability and competitiveness of the financial system.*

These two elements should be considered as building blocks for the refoundation of the global financial system.

3. Preventing distortions in competition linked to short-term crisis management

The extent and potential spill-over effects of the crisis called for immediate public stabilisation measures to restore confidence and proper functioning of the financial sector. As was already briefly mentioned, it is important that these crisis management measures clearly identify the institutions, markets and practices which were at the source of the current situation and need short-term rescue plans. However, fundamentally sound institutions should not be unduly overburdened with requirements which are not proportionate to the risks incurred. In fact, *weakening them could make the situation even worse.*



Besides, the *injection of public capital in banking institutions, when required due to the current disrupted market conditions, should in no way put into question the level playing field* on banking and financial markets. Therefore banks supported by national governments should not benefit from disproportionate or unfair advantages, which would harm the rest of the banking sector. Adequate information of the general public should be provided with regards to governments' participation to the capital of banks and the reasons underlying these decisions.

4. Addressing market and regulatory failings associated with the financial crisis

4.1. Enhancing sound regulation and strengthening transparency

WSBI calls for robust and trustful banking and financial systems, through the development, all over the world, of *sound practices in banking supervision*, built on proportionate and adapted rules. Efficient banking regulatory frameworks require balanced provisions to bring stability, to allow prudent innovation and to enable each type of market players to develop their activities.

WSBI supports an improved level of market transparency and calls for all market participants to be subject to appropriate regulation. In particular,

- the definition of an appropriate framework for hedge funds, with their strong potential impact for the stability of the financial system should be explored under the auspices of the International Organisation of Securities Commissions (IOSCO);
- the creation of a legal framework, requiring the registration and imposing the surveillance of credit rating agencies should be a priority to increase the transparency of rating methodologies, mandatorily request the disclosure of ratings performance, prevent conflicts of interest and enhance recordkeeping and reporting obligations.

There is also a need to reassess a number of current accounting practices, *to ensure the quality of information disclosed, give the assurance that it reflects the genuine situation of financial institutions and prevent the dissemination of misleading data sets*, especially in times of market disruption. In this respect, it will be necessary to rework the IFRS framework in such a way that undesirable pro-cyclical effects which reinforced the crisis are avoided in the future. The recent events have demonstrated that over-reliance on market value not only increases pro-cyclicality, but also results in providing an inaccurate image of a company's financial situation.

WSBI would support a thorough analysis of the Basel II framework, to identify potential weaknesses, which could have contributed to the current situation. It is nevertheless of the opinion that the Basel II approach should remain the reference to monitor capital requirements. *In this respect, WSBI welcomes the recent Basel Committee initiatives* proposing overall enhancements to the Basel II capital framework. For WSBI member banks subject to its requirements, the framework, although at an early stage of its implementation, has definitely contributed to improving risk management. Besides, it has still large unexplored resources such as Pillar 2, that has the potential of preventing much of the risk-taking that contributed to the current crisis. Preliminary lessons drawn from the crisis point to some of its shortcomings, such as securitisation-related aspects. A more comprehensive, fair assessment should be undertaken in order to establish whether and to what extent it eventually contributed to the crisis. However, questioning it altogether would be counterproductive.



WSBI will bring its input to the ongoing consultation on the enhancements to the framework, which at this stage seek to help ensuring that the risks attached to securitisations and exposures to off-balance sheet vehicles are better reflected in minimum capital requirements, risks management practices and accompanying disclosures to the public. WSBI suggests that areas which could be further investigated include the trading book, convergence on Pillar 2 and liquidity risk management. Particular attention should also be given to carefully assess and where required prevent the potential pro-cyclical effects of the current regulatory framework applicable to banks and to ensure a consistent approach between accounting rules and prudential standards.

WSBI would like to recall some of the commitments taken during the November 2008 Washington Summit by highlighting that:

- in light of a number of recent market events, it welcomes efforts to review the reorganisation and bankruptcy regimes in order to allow for an orderly winding-up of large and complex cross-border financial institutions;
- it is in favour of solid and strong schemes for the guarantee of deposits and would encourage all G20 members to enhance their efforts with a view to ensure an appropriate level of protection for banks' customers;
- it is convinced of the benefits of further guidance to strengthen banks' risk management practices and would encourage the review of internal control procedures and the implementation of strengthened policies for sound risk management.

The opportunity to review the *corporate governance framework* applicable to banking institutions, as defined by the Basel Committee in the "Sound corporate governance principles for banking organisations" on the basis of the OECD "Principles of Corporate Governance", should also be assessed. This could strengthen the accountability and responsibility of the banks' management with regard to the risk policy applied.

WSBI also believes that the remuneration schemes of some banks leading to encouraging short-term profit maximisation should be avoided, especially when they are incompatible with sound risk management practices and have strong pro-cyclical effects. Financial institutions should therefore be encouraged to develop remuneration policies which create incentives for long-term profitability. This approach is strongly encouraged throughout the WSBI network.

4.2 Reinforcing international co-operation, especially in the field of supervision

As a result of market consolidation over the last years, financial markets have seen the emergence of mega-banks and financial conglomerates, operating across financial sectors (banking, insurance, securities) and across countries. These increasingly interconnected financial institutions, involved in engineering ever more complex products, have dramatically increased systemic risk and the current crisis situation evidences the impact of their failures on the overall economic stability. It is therefore an urgent necessity to focus on the definition of a proper and efficient system to adequately oversee, examine and regulate this category of market players. The question of whether the development of such "mammoth" financial institutions should be supported also deserves to be raised. The role of the Financial Stability Forum (FSF) in this debate will be central.

The much-needed reflection on how to improve international and cross-sectoral cooperation to better regulate and control these mega-institutions should not be made to the detriment of other financial services players, and especially proximity banking institutions such as WSBI member banks. These banks primarily focus on serving domestic markets, with a strong anchorage at



regional and local level. Their retail clients are attached to the close and long-term relationships developed with these local institutions, with a thorough knowledge of the local market and context.

It is essential that these different types of banking institutions, despite their differences, can operate in a level playing field. This highlights the need for an overall system which is flexible enough to meet the challenge of embracing a wide spectrum of market participants, as well as - at the same time – keeping oversight and regulation as close as possible to the relevant national, regional and local markets.

In this context and as far as supervision is concerned, *WSBI strongly supports the recognition of the central role of local supervisory authorities*, given their familiarity with local markets and their proximity to the supervised entities. The current crisis has demonstrated that they are the best placed to react because of their thorough knowledge of supervised entities and markets and their closeness and easy access to them. This holds true not only for nationally active banks but also for cross-border institutions: any supervisory framework at supra-national level will always have to build on the work conducted by local supervisory authorities.

Appropriate mechanisms to enhance supervisory convergence further, through cooperation and coordination within supervisory colleges should also be set up for all cross-border financial institutions. The Financial Stability Forum should be responsible to define principles, policies and standard to organise this interaction.

WSBI is convinced that a two-tier supervisory architecture, which would consist of adding a new layer of supervision specifically for cross-border financial institutions, is not an appropriate way forward as it would raise serious level playing field questions. Likewise, WSBI is of the opinion that the lead supervisor approach, as suggested by some in Europe, is not the adequate supervisory architecture either for a number of reasons and in particular as it would result in distortions of competition when banking institutions within one market are subject to different supervisory regimes.

4.3. Reforming international financial institutions

WSBI is clearly in favour of strengthening further financial institutions and welcomes the decision already taken at the occasion of the November 2008 Washington Summit with regards to the expansion of the *Financial Stability Forum (FSF)*. It would in this respect suggest going one step further, with a view to develop a permanent channel for dialogue between the FSF and the financial services industry: a consultative panel of representatives of market participants, from all segments of the industry, could be set up, with the main tasks to document the FSF about major financial market evolutions and trends.

Besides, and given that the mandate of the FSF should be widened to include a more coordinating role to support cooperation between the different national and sectoral financial services authorities, WSBI would encourage the FSF to launch open consultations on measures or guidelines envisaged, involving all interested stakeholders including market players. This would be useful occasions to test the viability and feasibility of the proposed measures, and to ensure that they would not have undesirable side effects.

As far as the *International Monetary Fund (IMF)* is concerned, WSBI is of the opinion that as the only multilateral organisation monitoring macroeconomic interdependence and financial markets integration, the IMF's surveillance mandate should form the core of its responsibility. In this



capacity, IMF should be responsible to alert member countries about vulnerabilities affecting global macroeconomic stability and inducing risks of major financial crises with potential contagion effects, thus advising on corrective policies and desirable immediate actions.

As part of the strengthening of the IMF role, WSBI welcomes the commitment taken at the November 2008 Washington Summit that all G20 members will undertake a Financial Sector Assessment Programme (FSAP) report. This will play a key role to increase the effectiveness of efforts to promote the soundness of financial systems in all member countries.

In addition, the IMF surveillance of newly industrialised countries with sizeable economies should be strengthened to avoid potential regional and global risks associated with their economic policies. As a consequence, the IMF governance structure should be revised to ensure a balanced and representative distribution of voting to accommodate sizeable and systemically important economies.

Given the respective mandates of the IMF and of the FSF - the former in charge of assessing macro-financial risks and systemic vulnerabilities, the latter responsible to assess financial system vulnerabilities, drawing on the analysis of its member bodies- the two institutions should be invited to provide joint risk evaluations and mitigation reports. This coordinated approach would support the efforts of national governments in developing and implementing policies for a sounder financial system.

4.4. Supporting financial sectors in developing economies

Emerging and developing economies have been spared to some extent from the first round causalities, because most of them have stayed clearly away at this stage from the complex financial products that hastened the world in this global crisis. Despite the fact that these economies have remained relatively directly unaffected, they are not immune against external shocks, and certainly not from the economic downturn forecast on developed markets.

Such a challenging scenario should lead the international community, and specifically International Financial Institutions, to encourage government of these countries to implement countercyclical policies to stabilize internal demand and maintain public trust in financial markets, and to value alternative sources of capital.

Enabling developing economies to built up the *relevant banking infrastructure to mobilize domestic savings efficiently to finance development and reduce their dependence on foreign savings* should therefore be one of the main lessons from the crisis, which should be turned into a priority on the development agenda. This would involve facilitating the setting-up of banking institutions with wide distribution networks and delivery channels, designing appropriate, valuable and convenient products, promoting a savings culture, especially among households and young people, deepening domestic markets via financial inclusion, supporting technology innovation etc. A strong commitment to these strategic objectives, from IFIs, partners in developed countries, and emerging and developing countries themselves, will contribute to the emergence of more socially-efficient financial systems that progressively drive the developing economies towards a sustainable, stable, balanced and fair growth path.