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A Critical Assessment of Seven Reports on Financial Reform: A Minskyan Perspective. Part IV: Summary tables

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Working Paper No. 574.4

A Critical Assessment of Seven Reports on Financial Reform: A Minskyan Perspective, Part IV:

Summary Tables

by

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ABSTRACT

This four-part study is a critical analysis of several reports dealing with the reform of the financial system in the United States. The study uses Minsky's framework of analysis and focuses on the implications of Ponzi finance for regulatory and supervisory policies. The main conclusion of the study is that, while all reports make some valuable suggestions, they fail to deal with the socioeconomic dynamics that emerge during long periods of economic stability. As a consequence, it is highly doubtful that the principal suggestions contained in the reports will provide any applicable means to limit the worsening of financial fragility over periods of economic stability. The study also concludes that any meaningful systemic and prudential regulatory changes should focus on the analysis of expected and actual cash flows (sources and stability) rather than capital equity, and on preventing the emergence of Ponzi processes. The latter tend to emerge over long periods of economic stability and are not necessarily engineered by crooks. On the contrary, the pursuit of economic growth may involve the extensive use of Ponzi financial processes in legal economic activities. The study argues that some Ponzi processes—more precisely, pyramid Ponzi processes—should not be allowed to proceed, no matter how severe the immediate impact on economic growth, standards of living, or competitiveness. This is so because pyramid Ponzi processes always collapse, regardless how efficient financial markets are, how well informed and well behaved individuals are, or whether there is a "bubble" or not. The longer the process is allowed to proceed, the more destructive it becomes. Pyramid Ponzi processes cannot be risk-managed or buffered against; if economic growth is to be based on a solid financial foundation, these processes cannot be allowed to continue. Finally, a supervisory and regulatory process focused on detecting Ponzi processes would be much more flexible and adaptive, since it would not be preoccupied with either functional or product limits, or with arbitrary ratios of "prudence." Rather, it would oversee all financial institutions and all products, no matter how new or marginal they might be.

See also, Working Paper Nos. 574.1, 574.2, and 574.3.

Keywords: Regulation; Supervision; Financial Reform Minsky; Central Banking

JEL Classifications: E58, G01, G18, G28, G38

TREASURY RECOMMENDATIONS	Comments
Short-Term Recommendations	
President's Working Group (PWG) on Financial Markets Treasury recommends the modernization of the current PWG Executive Order in four different respects to enhance the PWG's effectiveness as a coordinator of financial regulatory policy. First, the PWG should continue to serve as an ongoing inter-agency body to promote coordination and communication for financial policy. But the PWG's focus should be broadened to include the entire financial sector, rather than solely financial markets. Second, the PWG should facilitate better inter-agency coordination and communication in four distinct areas: mitigating systemic risk to the financial system, enhancing financial market integrity, promoting consumer and investor protection, and supporting capital markets efficiency and competitiveness. Third, the PWG's membership should be expanded to include the heads of the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and the Office of Thrift Supervision (OTS). Similarly, the PWG should have the ability to engage in consultation efforts, as might be appropriate, with other domestic or international regulatory and supervisory bodies. Finally, it should be made clear that the PWG should have the ability to issue reports or other documents to the President and others, as appropriate, through its role as the coordinator for financial regulatory policy.	Yes, and this agency should become very important in future financial systems by centralizing information and focusing on the detection of systemic risk. This could include monthly meetings to discuss financial development. Members of other part of society should be included in discussion (labor, etc.)
Mortgage Origination First, a new federal commission, the Mortgage Origination Commission (MOC), should be created. The President should appoint a Director of the MOC for a four to six-year term. The Director would chair a seven-person board comprised of the principals (or their designees) of the Federal Reserve, the OCC, the OTS, the FDIC, the National Credit Union Administration, and the Conference of State Bank Supervisors. Federal legislation should set forth (or provide authority to the MOC to develop) uniform minimum licensing qualification standards for state mortgage market participants. These should include personal conduct and disciplinary history, minimum educational requirements, testing criteria and procedures, and appropriate license revocation standards. The MOC would also evaluate, rate, and report on the adequacy of each state's system for licensing and regulation of participants in the mortgage origination process. These evaluations would grade the overall adequacy of a state system by descriptive categories indicative of a system's strength or weakness. These evaluations could provide further information regarding whether mortgages originated in a state should be viewed cautiously before being securitized. The public nature of these evaluations should provide strong incentives for states to address weaknesses and strengthen their own systems. Second, the authority to draft regulations for national mortgage lending laws should continue to be the sole responsibility of the Federal Reserve. Given its existing role, experience, and expertise in implementing the Truth in Lending Act (TILA) provisions affecting mortgage transactions, the Federal Reserve should retain the sole authority to write regulations implementing TILA in this area. Finally, enforcement authority for federal laws should be clarified and enhanced. For mortgage originators that are affiliates of depository institutions within a federally regulated holding company, mortgage lending compliance and enforcement must be clarified. Any lingering issues concerning the authority of the Federal Reserve (as bank holding company regulator), the OTS (as thrift holding company regulator), or state supervisory agencies in conjunction with the holding company regulator to examine and enforce federal mortgage laws with respect to those affiliates must be addressed. For independent mortgage originators, the sector of the industry responsible for origination of the majority of subprime loans in recent years, it is essential that states have clear authority to enforce federal mortgage laws including the TILA provisions governing mortgage transactions.	Yes, mortgage sector needs more regulation. It is not just a question of rating state regulations but of making them better. Plus what if a state gets a low grade? Should the federal government impose prompt corrective actions to state regulations? Yes,some minimum standard should be established by the federal government. Ponzi finance should be at the core of those minimum standards

Liquidity Provisioning by the Federal Reserve First, the current temporary liquidity provisioning process during those rare circumstances when market stability is threatened should be enhanced to ensure that: the process is calibrated and transparent; appropriate conditions are attached to lending; and information flows to the Federal Reserve through on-site examination, or other means as determined by the Federal Reserve, are adequate. Key to this information flow is a focus on liquidity and funding issues. Second, the PWG should consider broader regulatory issues associated with providing discount window access to non-depository institutions	Yes, Minsky emphasizes the role of discount window refinancing channels. It should be the primary channels through which the central bank provides advances to financial institutions. By making it the main refinancing channel, the central bank will destigmatize the use of the discount window and will improve its awareness of financial practices (especially regarding position-making operations)
Intermediate-Term Recommendations	
Thrift Charter Treasury recommends phasing out and transitioning the federal thrift charter to the national bank charter as the thrift charter is no longer necessary to ensure sufficient residential mortgage loans are made available to U.S. consumers. With the elimination of the federal thrift charter the OTS would be closed and its operations would be assumed by the OCC.	?
Federal Supervision of State-Chartered Banks The direct federal supervision of state-chartered banks should be rationalized. One approach would be to place all such banking examination responsibilities for state chartered banks with federal deposit insurance with the Federal Reserve. Another approach would be to place all such bank examination responsibilities for state chartered banks with federal deposit insurance with the FDIC.	?
Payment and Settlement Systems Oversight To address the issue of payment and settlement system oversight, a federal charter for systemically important payment and settlement systems should be created and should incorporate federal preemption. The Federal Reserve should have primary oversight responsibilities for such payment and settlement systems, should have discretion to designate a payment and settlement system as systemically important, and should have a full range of authority to establish regulatory standards	Yes

Insurance To address these issues in the near term, Treasury recommends establishing an optional federal charter (OFC) for insurers within the current structure. An OFC structure should provide for a system of federal chartering, licensing, regulation, and supervision for insurers, reinsurers, and insurance producers (i.e., agents and brokers). It would also provide that the current state-based regulation of insurance would continue for those not electing to be regulated at the national level. States would not have jurisdiction over those electing to be federally regulated. However, insurers holding an OFC could still be subject to some continued compliance with other state laws, such as state tax laws, compulsory coverage for workers' compensation and individual auto insurance, as well as the requirements to participate in state mandatory residual risk mechanisms and guarantee funds. Treasury also recommends the establishment of the Office of National Insurance (ONI) within Treasury to regulate those engaged in the business of insurance pursuant to an OFC. The Commissioner of National Insurance would head ONI and would have specified regulatory, supervisory, enforcement, and rehabilitative powers to oversee the organization, incorporation, operation, regulation, and supervision of national insurers and national agencies. At the same time, Treasury believes that some aspects of the insurance segment and its regulatory regime require immediate attention. In particular, Treasury recommends that Congress establish an Office of Insurance Oversight (OIO) within Treasury. The OIO through its insurance oversight would be able to focus immediately on key areas of federal interest in the insurance sector. The OIO should be established to accomplish two main purposes. First, the OIO should exercise newly granted statutory authority to address international regulatory issues, such as reinsurance collateral. Therefore, the OIO would become the lead regulatory voice in the promotion of international insurance regulatory policy for the United States (in consultation with the NAIC), and it would be granted the authority to recognize international regulatory bodies for specific insurance purposes. The OIO would also have authority to ensure that the NAIC and state insurance regulators achieved the uniform implementation of the declared U.S. international insurance policy goals. Second, the OIO would serve as an advisor to the Secretary of the Treasury on major domestic and international policy issues. Once Congress passes significant insurance regulatory reform, the OIO could be incorporated into the OFC framework.	Yes, for uniform regulation across the USA. At least minimum standards
Futures and Securities Product and market participant convergence, market linkages, and globalization have rendered regulatory bifurcation of the futures and securities markets untenable, potentially harmful, and inefficient. To address this issue, the CFTC and the SEC should be merged to provide unified oversight and regulation of the futures and securities industries.	?

Long-Term Optimal Regulatory Structure	
Market Stability Regulator – The Federal Reserve The market stability regulator should be responsible for overall issues of financial market stability. The Federal Reserve should assume this role in the optimal framework given its traditional central bank role of promoting overall macroeconomic stability. As is the case today, important elements of the Federal Reserve's market stability role would be conducted through the implementation of monetary policy and the provision of liquidity to the financial system. In addition, the Federal Reserve should be provided with a different, yet critically important regulatory role and broad powers focusing on the overall financial system and the three types of federally chartered institutions (i.e., FIIs, FIDIs, or FFSPs). Finally, the Federal Reserve should oversee the payment and settlement system. In terms of its recast regulatory role focusing on systemic risk, the Federal Reserve should have the responsibility and authority to gather appropriate information, disclose information, collaborate with the other regulators on rule writing, and take corrective actions when necessary in the interest of overall financial market stability. This new role would replace its traditional role as a supervisor of certain banks and all bank holding companies.	Yes, very good. But there should be more than just the Federal Reserve involved. Systemic stability is not the exclusive business of bankers. Labor, non-financial sector, lawyers, financial experts should be involved. They should meet frequently. All regulators should also be present at meetings that would discuss recent trends in the financial industry and would analyze potential threats to systemic stability.
Prudential Financial Regulator The optimal structure should establish a new prudential financial regulator, PFRA. PFRA should focus on financial institutions with some type of explicit government guarantees associated with their business operations. Most prominent examples of this type of government guarantee in the United States would include federal deposit Chapter I: Executive Summary insurance and state-established insurance guarantee funds.	Why only those with government guarantee? All financial institutions, especially those that are not regulated, are Ponzi prone.
Business Conduct Regulator The optimal structure should establish a new business conduct regulator, CBRA. CBRA should monitor business conduct regulation across all types of financial firms, including FIIs, FIDIs, and FFSPs. Business conduct regulation in this context includes key aspects of consumer protection such as disclosures, business practices, and chartering and licensing of certain types of financial firms.	Yes. Financial products also should be monitored and approved before being used in the real world. Ponzi finance should be a central criterion.
Federal Insurance Guarantee Corporation The FDIC should be reconstituted as the Federal Insurance Guarantee Corporation (FIGC) to administer not only deposit insurance, but also the FIGF (if one is created and valid reasons to leave this at the state level exist as discussed in the report). The FIGC should function primarily as an insurer in the optimal structure. Much as the FDIC operates today, the FIGC would have the authority to set risk-based premiums, charge ex post assessments, act as a receiver for failed FIDIs or FIIs, and maintain some back-up examination authority over those institutions. The FIGC will not possess any additional direct regulatory authority.	?
Corporate Finance Regulator The corporate finance regulator should have responsibility for general issues related to corporate oversight in public securities markets. These responsibilities should include the SEC's current responsibilities over corporate disclosures, corporate governance, accounting oversight, and other similar issues. As discussed above, CBRA would assume the SEC's current business conduct regulatory and enforcement authority over financial institutions	Yes

CRMPG III RECOMMENDATIONS	Comments
Section II: Standards for Accounting Consolidation **II1.** The Policy Group endorses, in principle, the direction of the changes to the US GAAP consolidation rules provided that the changes are (1) principles-based, (2) convergent with International Financial Reporting Standards, and (3) accompanied by suitable disclosure and transition rules regarding regulatory capital which will provide flexibility in the implementation of these rules over a reasonable period of time. **II2.** The Policy Group recommends adoption of a single, principles-based global consolidation framework that is based on control and the ability to benefit from that control. **II3.** The Policy Group further recommends that the new consolidation framework require a reassessment of the consolidation analysis each reporting period based on changes in the control indicators specified in the preceding recommendation. **II4.** The Policy Group encourages standard setters and industry participants to work together toward achieving the goals discussed in this section on a global basis as soon as possible. **II-5.** The Policy Group recommends that standard setters and industry participants consider a holistic and principles-based approach to disclosure of off-balance sheet activities similar to that found in international standards. The disclosure framework should be fully integrated with enterprise-wide disclosures across the full spectrum of risks: market, credit, liquidity, capital, operational, and reputational. Enterprise-wide disclosure should be supplemented with detailed information that links to enterprise-wide disclosures and that changes in response to changing risks and uncertainties; for example, in the current environment, disclosures about residential and commercial real estate and leveraged loan exposures. **II-6.** The Policy Group recommends that firms provide tabular disclosures about the effects of restrictions on the use of consolidated assets, non-recourse liabilities, and minority interests.	Yes. It is good to create uniform accounting standards. Probably one also needs to improve macroeconomic accounting standards to account for cash-flow interrelationships. If off-balance sheet activities are going to be included in capital and liquidity requirements what is the point of having them.

Section III: High-Risk Complex Instruments **III-1.** The Policy Group recommends establishing standards of sophistication for all market participants in high-risk complex financial instruments. In recommending specific characteristics and practices for participants, it is guided by the overriding principle that all participants should be capable of assessing and managing the risk of their positions in a manner consistent with their needs and objectives. All participants in the market for high-risk complex financial instruments should ensure that they possess the following characteristics and make reasonable efforts to determine that their counterparties possess them as well: **III-2a.** The documentation of all high-risk complex financial instruments in cash or derivative form should include a term sheet: a concise summary highlighting deal terms and, where appropriate, collateral manager capabilities, and portfolio and deal payment structure. **III-2b.** The documentation associated with asset-backed high-risk complex financial instruments should include: A Preliminary and Final Offering Memorandum, A Marketing Book, Portfolio Stratifications, Cash Flow/Stress Scenarios **III-2c.** In addition to the documentation standards covered above, the Policy Group further recommends that term sheets and offering memoranda for all financial instruments having one or more of the key characteristics associated with high-risk complex financial instruments as discussed on pages 54, 56 must have a "financial health" warning prominently displayed in bold print indicating that the presence of these characteristics gives rise to the potential for significant loss over the life of the instrument. The "health warning" should also refer to all risk factors in the offering documents **III-3a.** The intermediary and counterparty should review with each other the material terms of a complex transaction prior to execution. **III-3b.** Both the intermediary and counterparty must make reasonable efforts to confirm the execution of a complex transaction in a timely manner. **III-3c.** When a counterparty requests a valuation of a high-risk complex financial instrument, the intermediary should respond in a manner appropriate to the purpose of the valuation. The intermediary's sales and trading personnel may provide a counterparty with actionable quotes or indicative unwind levels. Only groups independent of sales and trading should provide indicative valuations and only in writing. Where relevant, such indicative valuations should include information describing the basis upon which the valuation is being provided. **III-3d.** As a part of the relationship between intermediaries and their counterparties following trade execution, the intermediary should make reasonable efforts on a case-by-case basis to keep the counterparty informed of material developments regarding the performance of key positions. **III-4a.** Requiring all firms to follow statistically valid sampling techniques in assessing the quality of assets in a securitization; and **III-4b.** Encouraging disclosure to investors of due diligence results, including making the AUP letter publicly available.	Yes, we need to know more about the cash-flow implications of a security before it is allowed to go on the market. In addition, restrictions to certain customers must be established. We need a more proactive approach than just a health warning and better disclosure, as financial-market players are ready to bet the house (even with full disclosure), especially under strong competition and during the boom. This occurs whether or not financial companies are insured by the government so it is not just a question of moral hazard. Ponzi-practices should be banned or strongly discouraged for the sake of financial market participants' survival. The strength of counterparty should be included in valuating the benefit of a deal, but that strength should be based on the capacity of the counterparty to withstand a payment shock on its own (i.e., without using refinancing or liquidation of collateralized assets). Sampling should include all historical data.

Section IV: Risk Monitoring and Risk Management **IV-1a.** The Policy Group recommends that risk management and other critical control functions be positioned within all large integrated financial intermediaries in a way that ensures that their actions and decisions are appropriately independent of the income producing business units and includes joint approval of key products and transactions. This would generally mean having a chief risk officer (CRO) with a direct line of responsibility to the chief executive officer (CEO) and having the CEO and the board take a highly active role in ensuring that the culture of the organization as a whole recognizes and embraces the independence of its critical control functions. Even without the direct reporting, the CRO should have a clear line of communication to the board. **IV-1b.** The Policy Group further recommends that institutions ensure that their risk management functions are staffed appropriately for both the upside and the downside and are able to understand and properly size risks in tranquil markets as well as during periods of market stress. The risk management functions must also have the capacity to function effectively in periods of spikes in processing volumes and under various disaster recovery scenarios. **IV-2a.** The Policy Group recommends that all large integrated financial intermediaries evaluate the manner in which information relating to risk taking, risk monitoring, and risk management is shared with senior management and the board of directors and make necessary improvements to ensure that such information flows are timely, understandable, and properly presented. As a part of this effort, senior management should actively encourage ongoing discussion with board members in order to improve the quality, coverage and utility of information made available to the board. Each institution should evaluate how effective its information flows are as they relate to the intersection of credit, market, operational, and liquidity risk. **IV-2b.** The Policy Group recommends that each institution ensure that the risk tolerance of the firm is established or approved by the highest levels of management and shared with the board. The Policy Group further recommends that each institution ensures that periodic exercises aimed at estimation of risk tolerance should be shared with the highest levels of management, the board of directors and the institution's primary supervisor in line with Core Precept III, as discussed on pages 11, 12. **IV- 2c.** The Policy Group further recommends that large integrated financial intermediaries ensure that their treasury and risk management functions work with each other and with business units to manage balance sheet size and composition in a manner that ensures that the established risk tolerance is consistent with funding capabilities and ongoing efforts to manage liquidity risk. **IV-2d.** The Policy Group further recommends that each institution review its internal systems of both formal and informal communication across business units and control functions to ensure that such communication systems encourage the prompt and coherent flow of risk-related information within and across business units and, as needed, the prompt escalation of quality information to top management. **IV-3a.** The Policy Group recommends that, when schedules permit, the CEO and the second ranking officers of all large integrated financial intermediaries should frequently attend and participate in meetings of risk management related committees. **IV-3b.** The Policy Group further recommends that the highest levels of management periodically review the functioning of the committee structure to ensure, among other things, that such committees are appropriately chaired and staffed and there is an appropriate overlap of key business leaders, support leaders, and enterprise executives across committees to help foster firm-wide cooperation and communication. **IV-3c.** The Policy Group further recommends that for certain classes of firm-wide committees, such as those responsible for the approval of new products—especially new products having high financial, operational or	Strong governance is indeed essential and having a risk culture that is respected and well-understood by all the employees of the company is essential. The main challenge is to make sure that this culture is unaffected by the income producing units of the company. This is especially the case when: there is a strong competition in the sector, the economy has been performing well for a long time (sometimes decades); new ambitious managers come in the company with the willingness to show their talent and do not care about, or highly discount, past financial problems. In addition, a culture of Ponzi financing is not a good culture from the point of view of financial stability (of course from the point of view of short-term profitability it may be a good culture…). Risk tolerance of a firm changes overtime and increases over periods of enduring expansion because of the previous factors. There is nothing wrong about taking more risk as long as this does not imply Ponzi processes. Thus we need more than self-regulation of risk. Government oversight focused on detecting systemic risk is essential. This government oversight would include experienced members of the financial community. Senior members should be old enough to have experienced large financial troubles and also, and more importantly, to be free of the pressures to be lenient in order to be able to find a job back in the financial industry (their career should be behind them). The approval process of new financial products is very good but it needs to be performed by government agencies rather than internally, and it needs to meet specific criteria, notably in terms of hedge and speculative financing. Competitive pressure to take excessive risk is a problem that needs to be tackled. Alleviate competition.

reputational risks—the committee oversight process should include a systematic post-approval review process. This post-approval review process would assess the extent to which new products have, in commercial terms, performed as expected. Equally important, the process would assess whether the risk characteristics of the new product have been consistent with expectations, including the burden of the new products on technology and operating systems. Further, it is particularly appropriate to review at the earliest opportunity outsized profitability and market share gains to ensure that this does not reflect a problem with the original pricing or risk assessment of the product.	This, and what follows, is very good if it can be implemented. There is a need to develop an awareness of systemic risk in each financial company. The recognition of the importance of qualitative analysis through informal talks is essential.
IV- 4a. The Policy Group recommends that sustained investment in risk management systems and processes, and the careful calibration of such investment to business opportunities being pursued, be a key area of focus for a firm's senior management team. **IV-4b.** The Policy Group further recommends that each firm's CRO commission a periodic review and assessment of the firm's investments in risk management for presentation to its senior management and the audit committee of its board.	
IV-5a. The Policy Group recommends that all market participants implement a paradigm shift in credit terms, establishing arrangements that create more stable trading relationships, are less pro-cyclical, and thus reduce systemic risk. **IV-5b.** The Policy Group further recommends that each firm's senior management commission a periodic review of credit terms extended over a cycle, together with an assessment of the stability of such terms, for discussion with the firm's senior management.	Yes. Take into account interdependences
IV-6a. The Policy Group recommends that large integrated financial intermediaries ensure that their credit systems are adequate to compile detailed exposures to each of their institutional counterparties on an end-of-day basis by the opening of business the subsequent morning. In addition, the Policy Group recommends that large integrated financial intermediaries ensure their credit systems are capable of compiling, on an *ad hoc* basis and within a matter of hours, detailed and accurate estimates of market and credit risk exposure data across all counterparties and the risk parameters set out below. Within a slightly longer timeframe this information should be expandable to include: (1) the directionality of the portfolio and of individual trades; (2) the incorporation of additional risk types, including contingent exposures and second and third order exposures (for example, Structured Investment Vehicles (SIVs), Asset- Backed Securities (ABS), *etc.*); and (3) such other information as would be required to optimally manage risk exposures to a troubled counterparty. Large integrated financial intermediaries should be able to use exposure aggregation data both prospectively to avoid undue concentrations and, if necessary, in real time to react to unanticipated counterparty credit events. **IV-6b.** To demonstrate their compliance with the aforementioned standards, the Policy Group recommends that firms conduct periodic exercises for both individual and multiple institutional counterparties, and, to the extent that deficiencies are observed, develop remediation plans as a matter of urgency. **IV-7a.** The Policy Group recommends that large integrated financial intermediaries' risk analytics incorporate sufficient granularity to reveal less obvious risks that can occur infrequently but that may potentially have a significant impact (for example, basis risks between single name underliers and index hedges). However, risk management professionals and senior management must recognize the limitations of mathematical models, and that the tendency to overly formalize arcane aspects of an analysis can often detract from an understanding of the bigger picture implications of the total risk position. Incremental analytical detail must not be allowed to overwhelm users of the data. The salient risk points must be drawn out and made apparent, especially to senior management. Adequate time and attention by senior management must also be allotted to socializing the implications of the risk data.	

IV-7b. The Policy Group recommends that large integrated financial intermediaries ensure that assumptions underlying portfolio analyses are clearly articulated and are subject to frequent, comprehensive review. Alternative measures should be presented to demonstrate the sensitivity of the calculated metrics to changes in underlying assumptions.	Yes, very good. Emphasize Ponzi processes in addition to interdependences.
IV-7c. The Policy Group recommends that credit risks be viewed in aggregate across exposures, giving full consideration to the effects of correlations between directionality, should be evaluated based not only on positions within a large integrated financial intermediary, but also considering available data regarding the size and direction of positions the counterparty has at other firms.	Yes, and Ponzi processes should be eliminated.
IV-7d. The Policy Group further recommends that large integrated financial intermediaries work to supplement VaR as the dominant risk measure of market risk and current exposure as the dominant risk measure for credit risk, both for public reporting and for risk discussion purposes. Supplemental measures should include statistical information intended to display the most likely ways a large integrated financial intermediary or a managed portfolio could sustain significant losses, as well as an indication of the potential size of those losses.	Yes to the liquidity analysis. We also need a cash flow analysis that is more rigorous at the firm level, at the sectorial level, and at the macroeconomic level (no cash-flow macroeconomic accounting for the moment). In addition, the entire time frame should be taken into account, not just the past 30 days.
IV-8a. The Policy Group recommends that firms think creatively about how stress tests can be conducted to maximize their value to the firm including the idea of a reverse stress test where the emphasis is on the contagion that could cause a significant stress event to the firm.	
IV-8b. The Policy Group further recommends that firms incorporate the expanded suite of stress tests into a formalized production schedule, against which trends and developments in key risk factors and exposure amounts can be tracked.	In addition, this should be used proactively rather than only reactively. That is, it should be used to avoid taking excessive risks rather than just to "protect" against whatever risk is taken.
IV-9a. The Policy Group recommends that large integrated financial intermediaries adjust quantitative measures of potential credit risk with margined counterparties to take into account exceptionally large positions, as well as position concentrations in less liquid instruments. The adjustment should anticipate potentially protracted unwind periods and the risk of price gapping during unwinds.	
IV-9b. The Policy Group further recommends that consideration be given to collecting higher initial margin and higher haircuts from counterparties with outsized positions relative to market liquidity. Large integrated financial intermediaries should also evaluate the need to adjust internal pricing for large positions.	
IV-10a. The Policy Group recommends that large integrated financial intermediaries ensure that they employ robust, consistent pricing policies and procedures, incorporating disciplined price verification for both proprietary and counterparty risk trades. Special attention should be given to bespoke trades, structured products, illiquid products, and other difficult to price assets. A robust monitoring process should be employed to track stale prices and elevate unresolved issues.	
IV-10b. The Policy Group further recommends that firms and industry groups promote standardized and strengthened dispute resolution mechanisms and encourage the application of higher levels of resources to position pricing. Firms should also promote enhanced understanding of the need for cooperative behavior among firms (for example, when requested to provide indicative bids).	
IV-10c. The Policy Group further recommends that increased emphasis be given to using, wherever possible, transparent and liquid instruments rather than bespoke products. To incentivize this conduct, large integrated financial intermediaries should consider imposing internal charges against the P & L of hard to value and illiquid transactions, or other methods, such as higher capital charges, higher haircuts to collateralized borrowers, and the imposition of limits on allowed trade volumes. The recommendations incorporated in the section on High-Risk Complex Financial Instruments regarding documents and disclosure are of particular relevance to bespoke products.	
IV-11a. The Policy Group recommends that large integrated financial intermediaries ensure, in the absence of exceptional circumstances, that when the same instrument is held by different business units, such instrument is marked at the same price in each unit. Large integrated financial intermediaries should restrict those personnel	Why do we still having off-balance sheet accounting?

and groups that are authorized to provide marks to internal and external audiences. Any differentials in pricing across applications or units should be carefully considered and the rationale for such differences should be fully documented. Notwithstanding the above, it is recognized that for large integrated financial intermediaries, there are communication walls that are designed to fulfill regulatory requirements for the restriction of information flows. In these instances, it is understood that legitimate differences in pricing may occur.	
IV-12a. The Policy Group recommends that large integrated financial intermediaries ensure that a review of the systemic risk implications of incentives and consequent remedial actions is an integral component of each firm's risk management practices. Regulators should encourage this proactive review and assessment on a regular periodic basis. Regulators should identify practices that have the potential to destabilize markets during periods of stress and communicate their concerns aggressively.	Yes, one needs to evaluate the need for position-making operations once the net cash flows from operations and cash reserves are determined.
IV-12b. The Policy Group further recommends that, when considering new trade structures, strategies, or other opportunities, systemic risk implications be evaluated by the senior management of large integrated financial intermediaries. Trades or structures which materially add to systemic risk should be subject to particular scrutiny.	
IV-13a. The Policy Group recommends that all large integrated financial intermediaries should, on a regular basis, conduct liquidity stress tests to measure their maximum liquidity outflow (MLO). Stress tests should be based on scenarios that consider how normal sources of liquidity, both secured and unsecured, could be disrupted for the firm, the markets, or both. The stress test scenarios should focus on potential liquidity outflows, taking into account a firm's particular vulnerabilities.	
IV-13b. The Policy Group further recommends that, in addition, at a minimum, firms monitor their MLO within the first 30 days and for additional intervals within this timeframe (for example, overnight, one week, two weeks). The MLO is defined as the net loss of liquidity under the firm's most severe scenario from the time of the calculation for the tenors prescribed.	Yes, large decline in asset values should be included and a longer time horizon than past 30 days should be used to determine MLO.
IV-13c. The Policy Group recommends stress scenarios, both for purposes of stress testing and calculation of MLO.	
IV-14. The Policy Group recommends that all large integrated financial intermediaries maintain, on an ongoing basis, an unencumbered liquidity reserve of cash and the highest grade and most liquid securities. The liquidity reserve should be sized in relation to the firm's stress tests and MLO and should explicitly reflect the firm's liquidity risk tolerance and desired survival periods.	Yes, we need a better measure of financial fragility than leverage: focus on detecting Ponzi processes.
IV-15. The Policy Group recommends that all large integrated financial intermediaries maintain long-term structural liquidity in excess of their illiquid assets. In making this assessment, large integrated financial intermediaries should analyze the term structure of their long-term liabilities, the long-term stable portion of their deposits (where applicable), as well as equity capital. Illiquid assets should include those assets that cannot be converted to cash within a specified horizon and potential growth of those assets, as well as the haircuts necessary to convert generally liquid assets to cash through sale, securitization, or secured financing. The baseline assessment of whether a large integrated financial intermediary has long-term structural liquidity in excess of its illiquid assets should reflect current business conditions. However, the amount of this excess (the cushion) should reflect an evaluation of the assets and liabilities under stressed conditions. This cushion should be replenished with structured long-term liabilities, with tenors appropriate to market conditions, business strategy, and existing debt maturities.	
IV-16. The Policy Group recommends that a firm's liquidity plan and any stress tests mentioned above include, in all instances, the full set of on- and off-balance sheet obligations. In addition, they must reflect a clear view of how the firm will address non-contractual obligations that have significant franchise implications. While some non-contractual obligations may not lend themselves to incorporation into the core stress scenarios, an evaluation of how such exposures will play out in different market environments should be an overlay to the	

core stress scenarios. In addition, a clear assessment of how practices in relevant markets (for example, SIVs and auction rate securities) will affect an individual firm's conduct should be directly factored into liquidity planning. The above liquidity exposures should be fully priced under the firm's transfer pricing policies (see Recommendation V-17).

IV-17. The Policy Group recommends that all large integrated financial intermediaries incorporate appropriate pricing-based incentives for the full spectrum of their funding activities. This includes a funds transfer pricing policy that assigns the cost of funding to businesses that use funding and credits the benefits of funding to businesses that provide it. This must encompass both on- and off-balance sheet activities (for example, contingent funding), as well as potential funding needs related to actions that might be taken to preserve the institution's reputation. The funds transfer pricing process should be informed by stress testing efforts that identify potential vulnerabilities and assign the related costs to the businesses that create them. The methodology should provide direct economic incentives factoring in the related liquidity value of assets and behavioral patterns of liabilities. The costs and benefits identified should be assigned to specific businesses and, under all circumstances, used in evaluating the businesses' performance.

IV-18. The Policy Group recommends that to manage, monitor, and control funding liquidity risk, treasury officials in particular need to be included in an enterprise-wide risk management process with appropriate channels of communication. The evaluation of the interconnected elements of these risks requires seamless communication across all risk disciplines, as well as between risk management functions, treasury and the underlying businesses. All integrated financial services firms should hold regularly scheduled meetings of an oversight committee represented by the above disciplines to monitor the firm's liquidity positions.

IV-19. The Policy Group recommends that firms explicitly coordinate across their liquidity and capital planning processes and, at a minimum, ensure that critical information flows between the two processes. Executive management must have the capacity to evaluate and incorporate the highly integrated nature of the two disciplines into its planning activities.

IV-20a. The Policy Group re-affirms its recommendation that for large integrated banks and investment banks, Basel II should remain the primary capital standard that such institutions, their primary supervisors, and the marketplace generally look to in making judgments about capital adequacy.

IV-20b. The Policy Group recommends, at least for the present, that the existing Basel II standards for minimum capital and well-capitalized institutions be maintained. In taking that position, the Policy Group recognizes that the experience of the credit market crisis provides a sobering reminder to individual institutions, their senior management and their supervisors that future judgments about capital adequacy should be more sensitive to downside risks than perhaps has been the case in the past.

IV-20c. The Policy Group further recommends that supervisory judgments about capital adequacy for all large integrated banks and investment banks give primary weight to case-by-case evaluations based on the range of criteria contained in Basel II, Pillar II, and, when necessary, such judgments should be promptly shared with individual institutions.

V-20d. The Policy Group strongly recommends that every reasonable effort be made by the international community of supervisory authorities to (1) seek to stabilize, at least for a reasonable period of time, the methodology associated with Basel II, (2) move toward a common implementation date across major jurisdictions, and (3) insure a competitive and supervisory level playing field in the application of Basel II across classes of institutions and across national boundaries.

IV-21a. The Policy Group recommends that where the use of leverage ratios is compulsory, supervisors monitor such leverage ratios using the Basel II, Pillar II techniques and intervene regarding the adequacy of such leverage ratios only on a case-by-case basis.

IV-21b. The Policy Group recommends that efforts be directed at either (1) framing more meaningful leverage

ratios where they exist or (2) phasing out their use and implementing alternative risk measures that more effectively fulfill their intended objectives.	
Section V: Enhanced Credit Market Resiliency **V-1.** The Policy Group recommends trade date (T+0) matching for electronically eligible transactions. **V-2.** The Policy Group recommends the linkage of confirmation and settlements. **V-3.** The Policy Group recommends a tiered approach to market participation and incentive structure **V-4.** The Policy Group recommends incentives to buy-side participants. **V-5.** The Policy Group recommends that market participants should seek to streamline their methods for trade execution and confirmation/affirmation, which should facilitate an end-to-end process flow consistent with same-day matching and legal confirmation. **V-6.** The Policy Group recommends that senior leaders of trading support functions should clearly articulate to senior management the resource requirements necessary to achieve the same-day standards. Recognizing the expense management imperatives driven by recent market conditions, senior management should make every effort to help support functions achieve these standards for the overarching benefit of enhancing market resilience. **V-7.** The Policy Group strongly urges that major market participants should deploy a combination of utility and vendor-supplied solutions and should, at a minimum, ensure interoperability of those solutions. **V-8.** The Policy Group recommends that major market participants on both the sell and buy-sides should make every reasonable effort to speed up the adoption of electronic platform usage. This should entail revisiting the priorities in development and testing schedules. **V-9.** Consistent with Recommendation V-7 above, the Policy Group further recommends that major market participants on both the sell- and buy-sides should hasten their adoption of tools that facilitate standardization in the marketplace. This will in turn facilitate the achievement of the next generation goals for the timeliness and integrity of transaction details. **V-10.** The Policy Group further recommends frequent portfolio reconciliations and mark-to-market comparisons, including on collateralized instruments. **V-11.** ISDA Credit Support Annex documents spell out the bilateral terms of the margin process. While the process is generally standardized, the Policy Group recommends that the industry needs to find an effective means to resolve valuations disputes, particularly for illiquid products. Doing so is likely to be a difficult and demanding matter and therefore an industry-wide approach may have to be considered. **V-12.** The Policy Group recommends that, as mark-to-market disputes inevitably surface through the collateral portfolio reconciliation process, the information should be passed to the executing trading desks on a real-time basis to allow for research and resolution. This should, of course, be done with appropriate anonymity of the counterparty's identity, positions, and broader portfolio. A close alignment of the collateral team with trading desks—without violating the fire walls and controls that are critically important to the integrity of the financial system—would facilitate such information sharing. As necessary, significant and large value collateral disputes should promptly be escalated to the appropriate senior officers. **V-13.** The Policy Group recommends that dealers, investors, and the clearing banks agree on "Best Practices" to govern the tri-party repo market. **V-14.** The Policy Group recommends that market participants actively engage in single name and index CDS trade compression. ISDA has agreed on a mechanism to facilitate single name trade compression with Creditex and Mark-it Partners. Established vendor platforms exist for termination of offsetting index trades, and we urge major market participants to aggressively pursue their use. **V-15.** Based on the considerations above, the Policy Group recommends that the industry, under the auspices of the current ISDA Portfolio Compression Working Group, commit immediately and with all due speed to	All this looks good. I do not feel qualified to comment on those specifically. The only thing I may say is that mark-to-market accounting is probably not appropriate for illiquid and idiosyncratic financial claims. The same applies probably for other assets.

achieve consistency of the current product **V-16.** The Policy Group recommends that ISDA should update its Credit Derivative Definitions to incorporate the auction mechanism so that counterparties to new credit default swap trades commit to utilize the auction mechanism in connection with future credit events. **V-17.** The Policy Group recommends that ISDA should run a protocol (a so-called "big bang" protocol) to provide market participants with an operationally efficient means to amend their existing credit default swap trades to utilize the auction mechanism in connection with future credit events. This protocol should not effect any other changes to the bilateral agreements in effect between adopting counterparties. **V-18.** The Policy Group recommends that all large integrated financial intermediaries (*e.g.*, the major dealers) should promptly adopt the close-out amount approach for early termination upon default in their counterparty relationships with each other. We note that this can be agreed and suitably documented without making any other changes to the ISDA Master. The Policy Group expects that these arrangements will be in place in the very near term. **V-19.** The Policy Group recommends that a working group should be formed under the auspices of ISDA, with representatives of both dealer and buy-side firms, to review the methodology for counterparty terminations in order to (1) produce a set of best practices and suggested bilateral templates for the transparency of valuation methodologies and parameters, as noted above, for use by all market participants, (2) consider how contractual provisions could reflect prior reconciliation of valuation parameters and (3) seek to reconcile the differing views on what is necessary to evidence agreement that market inputs will be used unless commercially unreasonable. The Policy Group hopes that the working group will be able to report a recommended approach by December 31, 2008.	
V-20. The Policy Group recommends that all major market participants should periodically conduct hypothetical simulations of close-out situations, including a comprehensive review of key documentation, identification of legal risks and issues, establishing the speed and accuracy with which comprehensive counterparty exposure data and net cash outflows can be compiled, and ascertaining the sequencing of critical tasks and decision-making responsibilities associated with events leading up to and including the execution of a close-out event. **V-21.** The Policy Group recommends that all market participants should both promptly and periodically review their existing documentation covering counterparty terminations and ensure that they have in place appropriate and current agreements including the definition of events of default and the termination methodology that will be used. Where such documents are not current, market participants should take immediate steps to update them. Moreover, each market participant should make explicit judgments about the risks of trading with counterparties who are unwilling or unable to maintain appropriate and current documentation and procedures.	This and following recommendations are interesting.
V-22. The Policy Group recommends that the industry should consider the formation of a "default management group," composed of senior business representatives of major market participants (from the buy-side as well as the sell-side) to work with the regulatory authorities on an ongoing basis to consider and anticipate issues likely to arise in the event of a default of a major market counterparty. **V-23.** Recognizing the benefits of a counterparty clearing arrangement (CCP) as discussed above, the Policy Group strongly recommends that the industry develop a CCP for the credit derivatives market to become operational as soon as possible and that its operations adhere to the BIS Recommendations.	Yes, they should be part of monthly meeting discussing financial stability with regulators. Those meetings should include all sectors of the economy.

FSF RECOMMENDATIONS	Comments
II. Strengthened prudential oversight of capital, liquidity, and risk management	
Capital requirements **The Basel II capital framework needs timely implementation. Supervisors will assess the impact of the implementation.**	
II.1 The Basel II capital framework needs timely implementation. **II.2** Supervisors will assess the impact of Basel II implementation on banks' capital levels and will decide whether additional capital buffers are needed. **II.3** The BCBS will issue proposals in 2008 to raise capital requirements for certain complex structured credit products such as CDOs of asset-backed securities (ABSs) **II.4** The BCBS and IOSCO will issue proposals in 2008 to introduce additional capital requirements for credit exposures in the banks' and securities firms' trading books. **II.5** The BCBS will issue proposals in 2008 to strengthen the capital treatment for banks' liquidity facilities to off-balance sheet ABCP conduits. **II.6** Supervisors will continue to update the risk parameters and other provisions of the Basel II framework to ensure that its incentives remain adequate, and will rigorously assess banks' compliance with the framework. **II.7** Supervisors will assess the cyclicality of the Basel II framework and take additional measures as appropriate. **II.8** Insurance supervisors should strengthen the regulatory and capital framework for monoline insurers in relation to structured credit.	Yes, but we need to be clear that better capital requirements will not prevent moral hazard, and does not improve the financial strength of a company. The only thing it does is to better fine tune the buffer provided to creditors in case of problems. It does not do anything to prevent financial problems resulting from excessive risk taking in the first place. Rising capital requirements in period of enduring expansion is good if linked to systemic risk.
Liquidity management **Supervisors will issue for consultation sound practice guidance on the management and supervision of liquidity by July 2008.**	
II.9 The BCBS will issue consultation sound practice guidance on the management and supervision of liquidity by July 2008. **II.9** The BCBS will issue consultation sound practice guidance on the management and supervision of liquidity by July 2008. **II.10** National supervisors should closely check banks' implementation of the updated guidance as part of their regular supervision. If banks' implementation of the guidance is inadequate, supervisors will take more prescriptive action to improve practices. **II.11** Supervisors and central banks will examine the scope for additional steps to promote more robust and internationally consistent liquidity approaches for cross-border banks. This will include the scope for more convergence around liquidity supervision as well as central bank liquidity operations.	Liquidity management is indeed badly needed. However, this liquidity management and other risk management techniques should be used in two ways: - determining current needs for liquidity, capital, to meet probable problems from past decisions. - detecting Ponzi financial practices, and avoiding making decisions that put a company into a Ponzi process.
Supervisory oversight of risk management, including off-balance sheet entities **Supervisors will use Pillar 2 to strengthen banks' risk management practices, to sharpen banks' control of tail risks and mitigate the build-up of excessive exposures and risk concentrations.**	

II.12 National supervisors will use the flexibility within Basel II to ensure that risk management, capital buffers and estimates of potential credit losses are appropriately forward-looking and take account of uncertainties associated with models, valuations and concentration risks and expected variations through the cycle. National supervisors will report to the BCBS with a view to ensuring a level playing field and the BCBS will share its findings and actions with the FSF. **II.13** Supervisors will strengthen guidance relating to the management of firm-wide risks, including concentration risks. **II.14** Supervisors will strengthen stress testing guidance for risk management and capital planning purposes. **II.15** Supervisory guidance will require banks to manage off-balance sheet exposures appropriately. **II.16** Supervisors will issue guidance to strengthen risk management relating to the securitization business. **II.17** Supervisors will strengthen their existing guidance on the management of exposures to leveraged counterparties **II.18** Regulators of institutional investors should strengthen the requirements or best practices for firms' processes for investment in structured products. **II.19** Regulators and supervisors should work with market participants to mitigate the risks arising from remuneration policies.	Yes, while doing all this keep in mind the Ponzi finance criterion. Yes, a regulator should certify the safety of financial practices.
Operational infrastructure for OTC derivatives **Market participants should act promptly to ensure that the settlement, legal, and operational infrastructure underlying OTC derivatives markets is sound.**	
II.20 Market participants should amend standard credit derivative trade documentation to provide for cash settlement of obligations stemming from a credit event, in accordance with the terms of the cash settlement protocol that has been developed, but not yet incorporated into standard documentation. **II.21** Market participants should automate trade novations and set rigorous standards for the accuracy and timeliness of trade data submissions and the timeliness of resolutions of trade matching errors for OTC derivatives. **II.22** The financial industry should develop a longer-term plan for a reliable operational infrastructure supporting OTC derivatives.	Yes

III. Enhancing transparency and valuation	
Risk disclosures by market participants **Financial institutions should strengthen their risk disclosures and supervisors should improve risk disclosure requirements under Pillar 3 of Basel II.**	
III.1 The FSF strongly encourages financial institutions to make robust risk disclosures using the leading disclosure practices summarized in this report, at the time of their upcoming mid-year 2008 reports. **III.2** Going forward, investors, financial industry representatives, and auditors should work together to provide risk disclosures that are most relevant to the market conditions at the time of the disclosure. **III.3** The BCBS will issue by 2009 further guidance to strengthen disclosure requirements under Pillar 3 of Basel II.	Yes, but this should be done with systemic risk as the main criterion for disclosure. What is the most relevant at a specific period of time may not be the most relevant for systemic risk.
Accounting and disclosure standards for off-balance sheet entities	
III.4 The IASB should improve the accounting and disclosure standards for off-balance sheet vehicles on an accelerated basis and work with other standard setters toward international convergence.	Why still any off-balance sheet accounting?
Valuation **International standard setters should enhance accounting, disclosure, and audit guidance for valuations. Firms' valuation processes and related supervisory guidance should be enhanced.**	
III.5 The IASB will strengthen its standards to achieve better disclosures about valuations, methodologies, and the uncertainty associated with valuations. **III.6** The IASB will enhance its guidance on valuing financial instruments when markets are no longer active. To this end, it will set up an expert advisory panel in 2008. **III.7** Financial institutions should establish rigorous valuation processes and make robust valuation disclosures. **III.8** The BCBS will issue consultation guidance to enhance the supervisory assessment of banks' valuation processes and reinforce sound practices in 2008. **III.9** The International Auditing and Assurance Standards Board (IAASB), major national audit standard setters and relevant regulators should consider the lessons learned during the market turmoil and, where necessary, enhance the guidance for audits of valuations of complex or illiquid financial products and related disclosures.	Emphasize cash flows over historical or mark-to-market analysis.
Transparency in securitization processes and markets **Securities market regulators should work with market participants to expand information on securitized products and their underlying assets.**	
III.10 Originators, arrangers, distributors, managers, and CRAs should strengthen transparency at each stage of the securitization chain, by enhancing and standardizing information on an initial and ongoing basis about the pools of assets underlying structured credit products. **III.11** Originators and issuers of securitised products should be transparent about the underwriting standards for the underlying assets. They should also make available to investors and CRAs the results of their own due diligence. **III.12** Investors, and their asset managers, should obtain, from sponsors and underwriters of structured credit products, access to better information about the risk characteristics of the credits, including information about the underlying asset pools, on an initial and ongoing basis. **III.13** Securities market regulators will work with market participants to study the scope to set up a comprehensive system for post-trade transparency of the prices and volumes traded in secondary markets for credit instruments.	Transparency is indeed essential for both regulators and companies so that we know the extent of the risk taken, the extent of interrelationship, and the sources of potential problems. It is especially a problem for regulators. Lack of understanding and information by regulators leads to bad regulation and supervision, which leads to problems for financial investors.

IV. Changes in the role and uses of credit ratings	
Quality of the rating process **CRAs should improve the quality of the rating process and manage conflicts of interest in rating structured products.**	
IV.1 IOSCO will revise its Code of Conduct Fundamentals for Credit Rating Agencies by mid-2008. **IV.2** CRAs should quickly revise their codes of conduct to implement the revised IOSCO CRA Code of Conduct Fundamentals. Authorities will monitor, individually or collectively, the implementation of the revised IOSCO Code of Conduct by CRAs, in order to ensure that CRAs quickly translate it into action. **IV.3** CRAs should demonstrate that they have the ability to maintain the quality of their service in the face of rapid expansion of their activities, and allocate adequate resources to both the initial rating and to the rating's regular review.	Yes
Differentiated ratings and expanded information on structured products **CRAs should differentiate ratings on structured finance from those on bonds, and expand the initial and ongoing information provided on the risk characteristics of structured products.**	
IV.4 CRAs should clearly differentiate, either with a different rating scale or with additional symbols, the ratings used for structured products from those for corporate bonds, subject to appropriate notification and comment. **IV.5** CRAs should expand the initial and ongoing information that they provide on the risk characteristics of structured products.	More than a change in scale, we also need a change in the type of information provided to both financial investors and regulators. We also need to rework our understanding of what creditworthiness means. Today credit ratings are influenced positively by the rising price of collateralized assets even if the intrinsic capacity of borrowers to pay has not changed or even if it worsens. Rather than "will you repay on time?" a more relevant question is "how will you repay on time?" Financial deals that rely extensively on liquidation of collateralized assets and refinancing to meet debt commitments on time, either should not be seen as very creditworthy, or should have additional information provided with the rating. For example, AAA_L means that the rating is based on liquidations of collateral. This would help to detect the emergence of Ponzi processes more quickly.

CRA assessment of underlying data quality **CRAs should enhance their review of the quality of the data input and of the due diligence performed on underlying assets by originators, arrangers, and issuers involved in structured products.**	
IV.6 CRAs should review the quality of the data input and the due diligence performed by originators, arrangers and issuers.	Yes
Uses of ratings by investors and regulators **Investors should address their over-reliance on ratings. Investor associations should consider developing standards of due diligence and credit analysis for investing in structured products.**	

IV.7 Investors should reconsider how they use credit ratings in their investment guidelines and mandates and for risk management and valuation. Ratings should not replace appropriate risk analysis and management on the part of investors. Investors should conduct risk analysis commensurate with the complexity of the structured product and the materiality of their holding, or refrain from such investments. **IV.8** Authorities should check that the roles that they have assigned to ratings in regulations and supervisory rules are consistent with the objectives of having investors make independent judgment of risks and perform their own due diligence, and that they do not induce uncritical reliance on credit ratings as a substitute for that independent evaluation.	

V. Strengthening the authorities' responsiveness to risks	
Translating risk analysis into action **Supervisors, regulators and central banks—individually and collectively—will take additional steps to more effectively translate their risk analysis into actions that mitigate those risks.**	
V.1 Supervisors should see that they have the requisite resources and expertise to oversee the risks associated with financial innovation and to ensure that firms they supervise have the capacity to understand and manage the risks. **V.2** Supervisors and regulators should formally communicate to firms' boards and senior management at an early stage their concerns about risk exposures and the quality of risk management and the need for firms to take responsive action. Those supervisors who do not already do so should adopt this practice. **V.3** At the international level, the FSF will give more force to its own risk analysis and recommendations, both directly and through the actions of its members, by initiating and following up action to investigate and mitigate risk. **V.4** The FSF will establish a mechanism for regular interaction at senior levels with private sector participants, including investors and CRAs, for prompting mitigating actions to identified risks and weaknesses.	Yes, regulators need to be able to attract the best and brightest. A healthy financial system is as important as strong entrepreneurship to have a competitive financial system. It is not about "stealing" good people from private businesses but about creating a good foundation for business to thrive: remove the crooks and promote ethical individuals.
Improving information exchange and cooperation among authorities **Authorities' exchange of information and cooperation in the development of good practices will be improved at national and international levels.**	
V.5 The use of international colleges of supervisors should be expanded so that, by end-2008, a college exists for each of the largest global financial institutions. **V.6** Supervisors involved in these colleges should conduct an exercise, by 2009, to draw lessons about good practices. **V.7** To quicken supervisory responsiveness to developments that have a common effect across a number of institutions, supervisory exchange of information and coordination in the development of best practice benchmarks should be improved at both national and international levels. **V.8** Supervisors and central banks should improve cooperation and the exchange of information including the assessment of financial stability risks. The exchange of information should be rapid during periods of market strain. **V.9** To facilitate central bank mitigation of market liquidity strains, large banks will be required to share their liquidity contingency plans with relevant central banks.	Yes, a centralized regulator should be put in place and should meet frequently to discuss financial matters. Something similar to the FOMC meetings should be done for systemic risk: Ponzi process, high financial interrelationships, frauds, etc. Yes, the central bank should be constantly aware of the developments in the financial sectors, and of position-making practices.

Enhancing international bodies' policy work **International bodies will enhance the speed, prioritization, and coordination of their policy development work.**	
V.10 International regulatory, supervisory, and central bank committees will strengthen their prioritisation of issues and, for difficult to resolve issues, establish mechanisms for escalating them to a senior decision-making level. As part of this effort, they will establish timetables for required action and action plans for addressing delayed or difficult issues. **V.11** National supervisors will, as part of their regular supervision, take additional steps to check the implementation of guidance issued by international committees. **V.12** The FSF will encourage joint strategic reviews by standard-setting committees to better ensure policy development is coordinated and focused on priorities. **V.13** The FSF and IMF will intensify their cooperation on financial stability, with each complementing the other's role. As part of this, the IMF will report the findings from its monitoring of financial stability risks to FSF meetings, and in turn will seek to incorporate relevant FSF conclusions into its own bilateral and multilateral surveillance work.	Yes
VI. Robust arrangements for dealing with stress in the financial system	
Central bank operations **Central bank operational frameworks should be sufficiently flexible in terms of potential frequency and maturity of operations, available instruments, and the range of counterparties and collateral, to deal with extraordinary situations.**	
VI.1 To meet an increased but uncertain demand for reserves, monetary policy operational frameworks should be capable of quickly and flexibly injecting substantial quantities of reserves without running the risk of driving overnight rates substantially below policy targets for significant periods of time. **VI.2** Policy frameworks should include the capability to conduct frequent operations against a wide range of collateral, over a wide range of maturities and with a wide range of counterparties, which should prove especially useful in dealing with extraordinary situations. **VI.3** To deal with stressed situations, central banks should consider establishing mechanisms designed for meeting frictional funding needs that are less subject to stigma. **VI.4** Central banks should have the capacity to use a variety of instruments when illiquidity of institutions or markets threatens financial stability or the efficacy of monetary policy. **VI.5** To deal with problems of liquidity in foreign currency, central banks should consider establishing standing swap lines among themselves. In addition, central banks should consider allowing, in their own liquidity operations, the use of collateral across borders and currencies.	Yes. Federal Reserve already can do all this since the Glass Steagal Act of 1932. Plus the best way to remove the stigma is by making the window the usual central bank refinancing channel.
Arrangements for dealing with weak banks **Authorities will clarify and strengthen national and cross-border arrangements for dealing with weak banks.**	

VI.6 Domestically, authorities need to review and, where needed, strengthen legal powers and clarify the division of responsibilities of different national authorities for dealing with weak and failing banks. **VI.7** Internationally, authorities should accelerate work to share information on national arrangements for dealing with problem banks and catalogue cross-border issues, and then decide how to address the identified challenges. **VI.8** Authorities should agree to a set of international principles for deposit insurance systems. **VI.9** National deposit insurance arrangements should be reviewed against these agreed international principles, and authorities should strengthen arrangements where needed. **VI.10** For the largest cross-border financial firms, the most directly involved supervisors and central banks should establish a small group to address specific cross-border crisis management planning issues. It should hold its first meeting before the end of 2008. **VI.11** Authorities should share international experiences and lessons about crisis management. These experiences should be used as the basis to extract some good practices of crisis management that are of wide international relevance.	Yes

G-30 RECOMMENDATIONS	Comments
***Core Recommendation I** **Gaps and weaknesses in the coverage of prudential regulation and supervision must be eliminated. All systemically significant financial institutions, regardless of type, must be subject to an appropriate degree of prudential oversight.**	Yes, but the criterion for judging systematic significance is inappropriate or incomplete: not size, nor leverage, etc. Ponzi practices are what matters.
Prudential Regulation and Supervision of Banking Organizations **Recommendation 1:** a. In all countries, the activities of government-insured deposit-taking institutions should be subject to prudential regulation and supervision by a single regulator (that is, consolidated supervision). The largest and most complex banking organizations should be subject to particularly close regulation and supervision, meeting high and common international standards. b. Large, systemically important banking institutions should be restricted in undertaking proprietary activities that present particularly high risks and serious conflicts of interest. Sponsorship and management of commingled private pools of capital (that is, hedge and private equity funds in which the banking institutions' own capital is commingled with client funds) should ordinarily be prohibited and large proprietary trading should be limited by strict capital and liquidity requirements. Participation in packaging and sale of collective debt instruments should require the retention of a meaningful part of the credit risk. c. In general, government-insured deposit-taking institutions should not be owned and controlled by unregulated non-financial organizations, and strict limits should be imposed on dealings among such banking institutions and partial non-bank owners. d. To guard against excessive concentration in national banking systems, with implications for effective official oversight, management control, and effective competition, nationwide limits on deposit concentration should be considered at a level appropriate to individual countries.	Yes but it is not a matter of being government-insured or big but a matter of Ponzi financial practices. A single regulator should monitor those. Why should there still be unregulated financial institutions?
Consolidated Supervision of Non-bank Financial Institutions **Recommendation 2:** a. For those countries lacking such arrangements, a framework for national-level consolidated prudential regulation and supervision over large internationally active insurance companies should be established. b. An appropriate prudential regulator should be designated for those large investment banks and broker-dealers that are not organized as bank holding companies	Yes

Money Market Mutual Funds and Supervision **Recommendation 3:** a. Money market mutual funds wishing to continue to offer bank-like services, such as transaction account services, withdrawals on demand at par, and assurances of maintaining a stable net asset value (NAV) at par should be required to reorganize as special-purpose banks, with appropriate prudential regulation and supervision, government insurance, and access to central bank lender-of-last-resort facilities. b. Those institutions remaining as money market mutual funds should only offer a conservative investment option with modest upside potential at relatively low risk. The vehicles should be clearly differentiated from federally insured instruments offered by banks, such as money market deposit funds, with no explicit or implicit assurances to investors that funds can be withdrawn on demand at a stable NAV. Money market mutual funds should not be permitted to use amortized cost pricing, with the implication that they carry a fluctuating NAV rather than one that is pegged at US$1.00 per share.	Ok isolated depositors' claims relative to the rest of the business. Maturity matching should be promoted. This is part, but not all, of the criteria of hedge financing. Another important criterion is the size of cash inflows relative to cash outflows.
Oversight of Private Pools of Capital **Recommendation 4:** a. Managers of private pools of capital that employ substantial borrowed funds should be required to register with an appropriate national prudential regulator. There should be some minimum size and venture capital exemptions from such registration requirement. b. The prudential regulator of such managers should have authority to require periodic regulatory reports and public disclosures of appropriate information regarding the size, investment style, borrowing, and performance of the funds under management. Since introduction of even a modest system of registration and regulation can create a false impression of lower investment risk, disclosure and suitability standards will have to be reevaluated. c. For funds above a size judged to be potentially systemically significant, the prudential regulator should have authority to establish appropriate standards for capital, liquidity, and risk management. d. For these purposes, the jurisdiction of the appropriate prudential regulator should be based on the primary business location of the manager of such funds, regardless of the legal domicile of the funds themselves. Given the global nature of the markets in which such managers and funds operate, it is imperative that a regulatory framework be applied on an internationally consistent basis.	Criterion of size or leverage is not appropriate because it is too narrow and too restrictive which may constrain economic activity, and may prevent regulators from detecting dangerous financial practices. Plus all institutions should be regulated.

Government-Sponsored Enterprises (GSEs) **Recommendation 5:** a. For the United States, the policy resolution of the appropriate role of GSEs in mortgage finance should be based on a clear separation of the functions of private sector mortgage finance risk intermediation from government sector guarantees or insurance of mortgage credit risk. b. Governmental entities providing support for the mortgage market by means of market purchases should have explicit statutory backing and financial support. Hybrids of private ownership with government sponsorship should be avoided. In time, existing GSE mortgage purchasing and portfolio activities should be spun off to private sector entities, with the government, if it desires, maintaining a capacity to intervene in the market through a wholly owned public institution.	Yes, FNMA became private more for political reasons rather than for any economic reasons. It should have stayed a government institution.
Core Recommendation II **The quality and effectiveness of prudential regulation and supervision must be improved. This will require better resourced prudential regulators and central banks operating within structures that afford much higher levels of national and international policy coordination.**	Yes
Regulatory Structure **Recommendation 6:** a. Countries should reevaluate their regulatory structures with a view to eliminating unnecessary overlaps and gaps in coverage and complexity, removing the potential for regulatory arbitrage, and improving regulatory coordination. b. In all cases, countries should explicitly reaffirm the insulation of national regulatory authorities from political and market pressures and reassess the need for improving the quality and adequacy of resources available to such authorities.	Yes

Role of the Central Bank **Recommendation 7:** a. Where not already the case, central banks should accept a role in promoting and maintaining financial stability. The expectation should be that concerns for financial stability are relevant not just in times of financial crisis, but also in times of rapid credit expansion and increased use of leverage that may lead to crises. b. In countries where the central bank is not the prudential regulator, the central bank should have: (i) a strong role on the governing body of the prudential and markets regulator(s); (ii) a formal review role with respect to proposed changes in key prudential policies, especially capital and liquidity policies and margin arrangements; and (iii) a supervisory role in regard to the largest systemically significant firms, and critical payment and clearing systems. c. A sharp distinction should be maintained between those regulated banking organizations with normal access to central bank liquidity facilities and other types of financial institutions whose access, if any, should be limited to extreme emergency situations of critical systemic importance. d. Central bank emergency lending authority for highly unusual and exigent circumstances should be preserved, but should include, by law or practice, support by appropriate political authorities for the use of such authority in extending such credit to non-bank institutions. e. Central bank liquidity support operations should be limited to forms that do not entail lending against or the outright purchase of high-risk assets, or other forms of long-term direct or indirect capital support. In principle, those forms of support are more appropriately provided by directly accountable government entities. In practice, to the extent the central bank is the only entity with the resources and authority to act quickly to provide this form of systemic support, there should be subsequent approval of an appropriate governmental entity with the consequent risk transfer to that entity.	Yes, a central bank should be a key player in the regulatory and supervisory framework because it is the lender of last resort. Concerns about financial stability should be permanent, especially when the economy is doing well and nothing seems to happen. "Normal" growth of credit, "normal" use of leverage should be of great concern. What matters is not the normality relative to a trend but more the types of financial practice. I am not sure a difference should be made between those with normal and those with emergency access. That's not what is relevant because moral hazard problems are secondary to Ponzi processes (that reinforce the risk of moral hazard) To make sure that the central bank is never cornered to accept assets it does not want, a pre-approval of assets should occur before they are used in the real world. The central bank would accept any of the pre-approved financial instruments. And if there is nothing left to discount, the central bank can always grant unsecured advances.

International Coordination **Recommendation 8:** a. National regulatory authorities and finance ministers are strongly encouraged to adapt and enhance existing mechanisms for international regulatory and supervisory coordination. The focus of needed enhancements should be to: (i) better coordinate oversight of the largest international banking organizations, with more timely and open information sharing, and greater clarity on home and host responsibilities, including in crisis management; (ii) move beyond coordinated rule making and standard setting to the identification and modification of material national differences in the application and enforcement of such standards; (iii) close regulatory gaps and raise standards, where needed, with respect to offshore banking centers; and (iv) develop the means for joint consideration of systemic risk concerns and the cyclicality implications of regulatory and supervisory policies. The appropriate agencies should strengthen their actions in member countries to promote implementation and enforcement of international standards. b. Given the recurring importance of excessive leverage as a contributing factor to financial disruptions, and the increasingly complex ways in which leverage can be employed on and off balance sheets, prudential regulators and central banks should collaborate with international agencies in an effort to define leverage and then collect and report data on the degree of leverage and maturity and liquidity mismatches in various national systems and markets. c. To the extent new international regulatory organizations are ultimately needed, the initial focus should be on developing more formal regional mechanisms, such as in the European Union, but with continued attentiveness to the global dimension of most significant financial markets.	Yes, but define what "excessive" means for leverage. If a loose definition (like a threshold or a trend) is used this will lead to: changes in the threshold over good times, complaints that the threshold is too stringent and "prevents people from getting rich." Stronger definition of "excessive" is Ponzi. That should never occur or be strongly discouraged by all means.
Core Recommendation III **Institutional policies and standards must be strengthened, with particular emphasis on standards for governance, risk management, capital, and liquidity.** **Regulatory policies and accounting standards must also guard against pro-cyclical effects and be consistent with maintaining prudent business practices.**	Yes

Regulatory Standards for Governance and Risk Management **Recommendation 9:** Regulatory standards for governance and risk management should be raised, with particular emphasis on: a. Strengthening boards of directors with greater engagement of independent members having financial industry and risk management expertise; b. Coordinating board oversight of compensation and risk management policies, with the aim of balancing risk taking with prudence and the long-run interests of and returns to shareholders; c. Ensuring systematic board-level reviews and exercises aimed at establishing the most important parameters for setting the firm's risk tolerance and evaluating its risk profile relative to those parameters; d. Ensuring the risk management and auditing functions are fully independent and adequately resourced areas of the firm. The risk management function should report directly to the chief executive officer rather than through the head of another functional area; e. Conducting periodic reviews of a firm's potential vulnerability to risk arising from credit concentrations, excessive maturity mismatches, excessive leverage, or undue reliance on asset market liquidity; f. Ensuring that all large firms have the capacity to continuously monitor, within a matter of hours, their largest counterparty credit exposures on an enterprisewide basis and to make that information available, as appropriate, to its senior management, its board, and its prudential regulator and central bank; g. Ensuring industrywide acceptance of and action on the many specific risk management practice improvements contained in the reports of the Counterparty Risk Management Policy Group (CRMPG) and the Institute of International Finance.	All this is very good and full of good intentions. I have my doubt that this can be done at the firm level for several reasons: - competition is ferocious in the financial sector - what is "relevant" to determine risk changes and loosens significantly over periods of good time - back-office operators are not well considered by other managers because they do not generate money. Define what "excessive" means.

Regulatory Capital Standards **Recommendation 10:** a. International regulatory capital standards should be enhanced to address tendencies toward procyclicality. Benchmarks for being well capitalized should be raised, given the demonstrable limitations of even the most advanced tools for estimating firmwide risk. b. These benchmarks should be expressed as a broad range within which capital ratios should be managed, with the expectation that, as part of supervisory guidance, firms will operate at the upper end of such a range in periods when markets are exuberant and tendencies for underestimating and underpricing risk are great. c. The existing international definitions of capital should be reevaluated, looking toward close alignment on national definitions. d. Capital and risk disclosure standards should be reevaluated to provide a higher degree of transparency of a firm's risk appetite, its estimated needs for and allocation of economic capital, and its valuation practices.	Yes
Standards for Liquidity Risk Management **Recommendation 11:** a. Base-level liquidity standards should incorporate norms for maintaining a sizable diversified mix of long-term funding and an available cushion of highly liquid unencumbered assets. Once such standards are developed, consideration should be given to what is the preferred mix of senior and subordinated debt in bank capital structures. b. Supervisory guidance for liquidity standards should be based on a more refined analysis of a firm's capacity to maintain ample liquidity under stress conditions, including evaluation of the quality and effectiveness of its liquidity management policies and contingency funding plan. c. Liquidity disclosure standards, building on the suggested practices in the Basel Committee Principles, should complement the suggested improved disclosure practices for capital and risk profile information	Yes, and a stress period should include the whole financial history, no matter how "improbable," "old," and "exceptional" an event was.

Fair Value Accounting **Recommendation 12:** a. Fair value accounting principles and standards should be reevaluated with a view to developing more realistic guidelines for dealing with less liquid instruments and distressed markets. b. The tension between the business purpose served by regulated financial institutions that intermediate credit and liquidity risk and the interests of investors and creditors should be resolved by development of principles-based standards that better reflect the business model of these institutions, apply appropriate rigor to valuation and evaluation of intent, and require improved disclosure and transparency. These standards should also be reviewed by, and coordinated with, prudential regulators to ensure application in a fashion consistent with safe and sound operation of such institutions. c. Accounting principles should also be made more flexible in regard to the prudential need for regulated institutions to maintain adequate credit loss reserves sufficient to cover expected losses across their portfolios over the life of assets in those portfolios. There should be full transparency of the manner in which reserves are determined and allocated. d. As emphasized in the third report of the CRMPG, under any and all standards of accounting and under any and all market conditions, individual financial institutions must ensure that wholly adequate resources, insulated by a fail-safe independent decision-making authority, are at the center of the valuation and price verification process.	Rather than historical accounting and mark-to-market accounting, Minsky emphasized conditional cash-flow accounting. Solvency of a company is its capacity to generate a positive net cash flow from operations over the long run greater than debt commitments, rather than the capacity to have a positive net worth right now. Mark-to-market assumes that market-participants are always right not matter how short and blurred their views might be by the craziness of the moment (upward and downward). In addition, CDS and EDS create perverse incentives to bring down a company. Net cash flows should determine valuation and if net cash flows cannot be determined ever, there is probably no reason for an asset to exist.
Core Recommendation IV **Financial markets and products must be made more transparent, with better aligned risk and prudential incentives. The infrastructure supporting such markets must be made much more robust and resistant to potential failures of even large financial institutions.**	Yes, take the medical drug approach: - only for some people: qualification should be based on cash inflows and, secondarily, cash reserves (not refinancing source available or possibility to liquidate the encumbered asset) - if side effects kill you or leave you in bad shape, it should not exist: forbid Ponzi processes

Restoring Confidence in Securitized Credit Markets **Recommendation 13:** a. Market Supervision: Extensive innovation in the capital markets and the rapid growth of securitization make it imperative that securitized and other structured product and derivatives markets be held to regulatory, disclosure, and transparency standards at least comparable to those that have historically been applied to the public securities markets. This may require that a broader range of markets be monitored, that there be adequate transparency as to transaction volumes and holdings across all products, and that both credit and leverage elements of each product be thoroughly understood and monitored. b. Credit Underwriting Standards: The healthy redevelopment of securitized credit markets requires a restoration of market confidence in the adequacy and sustainability of credit underwriting standards. To help achieve this, regulators should require regulated financial institutions to retain a meaningful portion of the credit risk they are packaging into securitized and other structured credit products. c. Off-Balance-Sheet Vehicles: Pending accounting rule changes for the consolidation of many types of off-balance-sheet vehicles represent a positive and needed improvement. It is important, before they are fully implemented, that careful consideration be given to how these rules are likely to impact efforts to restore the viability of securitized credit markets.	Yes, but be mindful that more information and disclosure does not mean a better decision. Financial market participants may be willing to enter a Ponzi deal with perfect information about the risk. In fact "perfect" information may lead to a large boost in confidence and a sense of control, which may reinforce the willingness to enter in Ponzi processes.
Rating Agency Reforms **Recommendation 14:** Regulatory policies with regard to nationally recognized securities rating organizations (NRSROs) and the use of ratings should be revised, preferably on an internationally coordinated basis, to achieve the following: a. Users of risk ratings, most importantly regulated users, should be encouraged to restore or acquire the capacity for independent evaluations of the risk of credit products in which they are investing. b. Risk ratings issued by the NRSROs should be made more robust, to reflect the risk of potential valuation losses arising not just from default probabilities and loss in the event of default, but also from the full range of potential risk factors (including liquidity and price volatility). c. Regulators should encourage the development of payment models that improve the alignment of incentives among the providers of risk ratings and their clients and users, and permit users to hold NRSROs accountable for the quality of their work product.	Yes. Also need to review the notion of creditworthiness. Rising value of collateral increased the equity of the borrower without increasing his intrinsic capacity to repay. Lenders like to have more protection against loss of principal as it increases the chance of full recovery of stakes in case of default or loss of market value, but this does not say anything about the capacity of a borrower not to default in the first place. *Pre-loss* capacity to repay is what matters for judging the creditworthiness (i.e. capacity to repay). Doing otherwise will lead to a positive feedback between creditworthiness and value of collateral, leading to a Ponzi process (i.e., a process where the liquidation of the collateral is seen as a normal way to repay on time). Given the existence of CDS and EDS, it will also lead to bets that liquidation occurs and will give an incentive to structure financial products so that borrowers have a higher chance of defaulting and liquidating their collateral.

The Oversight of Credit Default Swaps (CDS) and Over-the-Counter (OTC) Markets **Recommendation 15:** a. Much-needed planned improvements to the infrastructure supporting the OTC derivatives markets should be further supported by legislation to establish a formal system of regulation and oversight of such markets. b. Given the global nature of the market, it is essential that there be a consistent regulatory framework on an international scale, and national regulators should share information and enter into appropriate cooperative arrangements with authorities of other countries responsible for overseeing activities.	Yes, empty ownership is a big problem also. No financial instruments should ever be unregulated. Currently financial instruments are introduced without being tested extensively to determine their implications and restriction on use, like if drugs were introduced to the public without trial and were judged by looking at how many people die or get very sick.
A Resolution Mechanism for Financial Institutions **Recommendation 16:** a. In countries where this is not already the case, a legal regime should be established to provide regulators with authority to require early warning, prompt corrective actions, and orderly closings of regulated banking organizations, and other systemically significant regulated financial institutions. In the United States, legislation should establish a process for managing the resolution of failed non-depository financial institutions (including non-bank affiliates within a bank holding company structure) comparable to the process for depository institutions. b. The regime for non-depository financial institutions should apply only to those few organizations whose failure might reasonably be considered to pose a threat to the financial system and therefore subject to official regulation. c. A regulatory body having powers comparable to those available for the resolution of banking institutions should be empowered to act as a receiver or conservator of a failed non-depository organization and to place the organization in liquidation or take action to restore it to a sound and solvent condition. d. The special treatment accorded to various forms of financial contracts under current U.S. law should be examined in light of recent experience, with a view toward resolving claims under these contracts in a manner least disruptive to the financial system. Improving Transparency of Structured Product Markets	

Recommendation 17: a. The disclosure and dissemination regime for asset-backed and other structured fixed income financial products (including securities and other financial products) in the public and private markets should be enhanced. b. The appropriate national regulator should, in conjunction with investors, determine what information is material to investors in these products and should consider enhancing existing rules or adopt new rules that ensure disclosure of that information, for both asset-backed and synthetic structured products. c. The appropriate national regulator should condition transactions in the private and wholesale markets on satisfaction of appropriate information disclosure standards.	Yes, disclosure should be improved but more disclosure does not mean better decisions. In addition, the information to provide should also have the regulators' concerns at heart. Detection of Ponzi processes should be central to the disclosure of information, especially because financial products that were first approved as safe can become Ponzi.
Sharing Market Activity and Valuation Information **Recommendation 18:** Efforts to restore investor confidence in the workings of these markets suggest a need to revisit evaluations of the costs and benefits of infrastructure investments that would facilitate a much higher level of transparency around activity levels, traded prices, and related valuations. Part of the costs of such changes is the impact on firm-specific concerns regarding the private nature of their market activity. These concerns, and direct investment costs, need to be weighed against the potential benefits of higher levels of market transparency	Yes, but again better transparency does not prevent a Ponzi process. Everybody may be very clear and well informed that an activity (or the continuation of existing level of profitability) requires growing refinancing and liquidation, but everybody may be willing to go for it if it is what preserves profitability. That should not be allowed.

GENEVA REPORT RECOMMENDATIONS	COMMENTS
Capital Requirements	
1. Banks, and any other financial institution subject to deposit insurance, should be subject to some (low) minimum capital requirement. This is not to be seen as a protection for the regulated institution (rather the reverse; it constrains the banks), but as a protection for the deposit insurance fund, and a trigger for p.c.a.	
2. All regulators/supervisors in each country should agree on their own list of systemic institutions and markets, and be prepared to exchange lists with supervisors in other countries. Although such lists should not be made public (o.a. moral hazard and the fuzzy definition of "systemic"), there should be mechanisms for ensuring that regulators/supervisors take this exercise most seriously.	
3. All such systemic institutions should be subject both to micro-prudential regulation, examining their individual risk characteristics (along the lines of Basel II) and to macro-prudential regulation, related to their contribution to systemic risk. We suggest that this latter be done by adjusting the micro-prudential ratio by a co-efficient relating to the macro-prudential assessed risk.	Macro and micro regulation is good but why not for all institutions. Plus, orient this regulation toward the detection of Ponzi processes.
4. Macro-prudential regulation should be countercyclical and lean especially against bubbles whose bursting can impair the financial intermediation sector.	Yes, but the criterion of a bubble is too loose. Lean against Ponzi finance.
5. We argue that the best measures of an institution's contribution to macro-prudential risk are its leverage, maturity mismatch, and rate of expansion. More precise endogenous risk-spillover measures that also take liquidity aspects into account should be developed. So we would interact each, systemic, institution's tier 1 Basel II ratio by multiplicand, which could be below, as well as above, unity, based on a mixture of leverage, maturity mismatch and growth.	These are some indicators, especially if they all work together. But a more effective way to have early and systematic detection would be to analyze cash flows
6. Institutions which are not individually systemic, but which are (i) highly leveraged with short-term debt and (ii) hold assets with low market liquidity (at times of a crisis), can nevertheless have systemic effects via joint herd-type behavior. So they should all, except for the tiniest, both report, and have some constraints (in the form again of a ladder of sanctions), on their macro-prudential riskiness, i.e., their leverage, maturity mismatch and credit expansion (which could perhaps vary between kinds of institutions, e.g., banks and hedge funds). It would be for discussion (and our group could not agree), whether such highly-leveraged, but individually non-systemic, institutions should also have *any* additional micro-prudential regulation.	Yes, but include tiniest too, because the latter may help to sustain a Ponzi process at the level of society rather than from crooks.
7. Asset-price and credit cycles differ from country to country, and from region to region. Although the principles of counter-cyclical regulation should be universal, its application would lead to differing ratios in each area applying the regulations, normally in the host country.	
8. Each host country (region) should have the right to designate a crossborder subsidiary, or branch, as "systemic." Systemic branches should be required to become subsidiaries. Foreign-owned subsidiaries should be subject to the same capital requirement calculations, and hold that in domestic assets, as its own domestic banks.	Yes
9. An alternative approach, which might be less radical, would be to generalize and to extend the present Spanish dynamic pre-provisioning scheme to all countries, though this also would need to be applied on a country-by-country basis. If this were to be done, IFRS would have to be revised to permit this.	
10.The application of macro-prudential measures should be by the central bank; for this purpose they should be able to undertake (on-site) supervision of individual systemic institutions, separately from the microprudential supervisor(s). Efforts should be made to limit the administrative burden of multiple supervisors, and reporting requirements and definitions should be harmonized.	Yes

Liquidity	
1. We propose a "mark to funding" approach to provide incentives for more long-term funding. This approach is, in effect, closely akin to the maturity mismatch ladder previously considered by the Basel Committee on Banking Supervision (BCBS) and by some central banks. 2. Unlike most such prior exercises we would also provide incentives to hold liquidity by, once again, interacting the assessed liquidity with the capital adequacy ratio. Liquidity is measured by an effective maturity mismatch which takes the market liquidity of assets (at times of crisis) into account. The more liquidity fell below the well-targeted level, the higher the CAR would have to be, and vice versa. The relationship (trade-off) need not, however, be linear. 3. We doubt whether additional private insurance can then help much on occasions when market and funding liquidity vanishes; the examples of the mono-lines and of AIG confirm our doubts. The answer would seem to be some combination of public sector market-making (as now by the Fed in the CP market), and public sector insurance (guarantees of one kind or another). 4. We suggest that mark-to-funding might be a principle that could apply to the portfolios of financial institutions for accounting purposes, either as an alternative, or a supplement, to the present categories, i.e., hold to maturity, available for sale, trading book. 5. To overcome debt overhand problems, the regulator should have the authority to convert existing debt into equity	Higher CAR may not help to fight liquidity crisis. Might help for some institutions but should be at least complemented by a conditional valuation.

Other Considerations	

1. We propose that supervisors should formulate a set of remuneration guidelines, and (as in other examples below), adjust capital ratios according to the degree of compliance.	
2. We advocate the central bank setting maximum loan-to-value (LTV) ratios for residential mortgages as an additional macro-prudential measure. This would involve, as a corollary, outlawing several obvious avoidance measures, e.g., second mortgages.	Yes, but go further. Forbid Ponzi financing of mortgages
3. We argue, at several points, that credit ratings are systematically misused in the regulatory process. Whereas we are happy to see further tightening of "conflict-of-interest" and transparency regulations, we would otherwise seek to exclude CROs from the regulatory network altogether. We regard both the Basel II approach to the use of credit ratings and the European proposals for their enhanced regulation as misconceived.	Yes
4. We support the efforts of the CRMPG to move systemically important derivative markets onto centralized clearing houses.	Yes
5. Each "individually systemic" financial institution should be required to provide annually a full contingency plan for the case of its own bankruptcy.	Yes
6. We cannot understand how, and why, the end-year spike in financial markets has been allowed to remain. It is both absurd and damaging. We suggest two alternative methods of eradicating it.	
7. Because cycles (in asset prices and credit) vary from country to country, as well as from time to time, we propose a shift of emphasis in regulatory powers toward the host country.	
8. Because crisis management is often extremely expensive, it has to be done by the (host) central bank in conjunction with its own ministry of finance. As soon as, but not before, the Eurozone obtains fiscal powers to manage any such crises, *then* macro-prudential management can be shifted from the national central banks to some federal euro-zone body.	
9. Whereas crisis management has to be done at a (national) level consonant with the availability of fiscal (taxpayer) funding, crisis prevention can, and should, be done internationally. We make several proposals to reform both the structure and remit of the Financial Stability Forum.	