

**Developing Internationally Agreed Financial-market Rules
Eight Areas to Concentrate on**

1. *Obligation to keep innovative financial instruments on the balance sheet:* We are all agreed that innovative financial instruments can bring tremendous advantages, for example, in terms of the targeted management of financial risks. One reason for the severity of the financial crisis lies in the situation whereby the tremendous innovative drive of the finance industry was also used to shift risks from financial institutes' balance sheets and thus circumvent prudential capital requirements. This must be prevented in future. We want banks to be able to take risks – but these risks should be limited to those that are backed-up by sufficient equity and are entered on bank balance sheets. This is the only kind of transparency that will provide protection against crises comparable to the one experienced at present and that will serve as a safeguard against the looming loss of confidence, which is calling the foundations of the financial industry into question. In future, financial innovations must be rendered transparent in terms of objectives and application, as this is the only way they can make a positive contribution to economic development and stability.
2. *Increasing bank liquidity cushions:* The massive liquidity crisis and freezing of interbank markets are clearly the predominant hallmark of the current banking crisis. After years of seemingly infinite liquidity on international markets, the financial institutions – and indeed central banks and supervisory authorities – were barely prepared for the crisis. The Basel Committee had already called for liquidity buffers to be established. We now need to put a figure on these buffers and implement them as quickly as possible at international level.
3. *International standards on greater personal liability for the financial market participants accountable:* Around the world, citizens are asking what further burdens they will have to bear in light of the financial crisis. In such a situation, it is simply impossible to explain to the public why the decision-makers responsible within the companies are not held to account for their misjudgements, and, instead, we still to a degree see instances where they depart from the companies with severance pay packages – those infamous 'golden parachutes' – worth millions. This trend is jeopardising public support for the market economy. That is why we now need international standards on greater personal liability for financial market practitioners. Such liability must reflect the corporate and social responsibility they bear.

4. *Adjusting incentive and remuneration schemes in the financial sector:* Existing incentive and remuneration systems must be scrutinised. Financial services make a major contribution to efficiency and value creation, but the breathtaking rate at which returns have developed in recent years is an expression of the mounting decoupling – from the real economy and from the cumulative risks tolerated in exchange for these profits. Sooner or later, such a race for returns leads to market collapse. I am convinced that this has a lot to do with financial-sector incentive and payment systems. That is why we need a discussion about reward and pay frameworks. Guidance and international standards are required in this field too so that more appropriate and more sustainable structures can establish themselves. One option would be an international code of conduct on responsible management. The code should then be reflected in corporate policy.
5. *Closer cooperation between FSF and IMF:* We, as members of the G7, have repeatedly called for early warning capacities to be reinforced and for cooperation between the IMF and FSF to be enhanced. The key to improvement lies in successfully bundling the core competencies of the two institutions. The IMF must decisively strengthen its analytical capabilities in the field of financial stability. The FSF must to a far greater extent ensure effective coordination of the work of individual national and international committees on financial stability. Building on this platform, we should examine whether the IMF and FSF should present an annual joint report on financial market stability. The IMF would then produce the analytical chapter following consultation with other relevant committees; on this basis, the FSF would then examine the need for concrete recommendations for action. Monitoring the implementation of past policy recommendations would be a further important task. A task which the IMF could undertake. A joint report would increase the transparency of discussions about necessary policy recommendations and thus raise the effectiveness of crisis prevention measures in particular.
6. *Banning detrimental short selling:* Speculating on falling asset prices through short-selling transactions may, in times of generally tight financial markets, lead to substantial burdens and possibly create a threat to financial market stability as well, especially if speculative activity is aimed at financial sector issuers. In light of the narrow ties between financial markets, measures adopted at national level to counteract speculative excesses are not always sufficient. In my view, we need to co-ordinate action in a more concerted fashion in future. Against this background, we should reach an international consensus about a ban on certain detrimental short-selling practices.

7. *Retention in the case of securitizations:* Splitting decisions about lending and the responsibility for risk has proven to be fatal in light of the current crisis. To achieve lasting risk awareness on the part of the banks and throughout the entire financial system, I suggest that it should no longer be possible for banks to securitize 100% of the lending risks they take and pass on as a consequence. In my view, the selling institute should be obliged to retain on its books a particular share of the credit risks it has entered into. There should be a discussion at G7 level regarding the appropriate percentage that is high enough to ensure behaviour factoring in risk on the one hand, while granting banks the additional leeway in lending that is economically desirable on the other. I feel a retention of up to 20% would be a conceivable figure. In my view, a corresponding rule should be applied internationally in order to avoid distortions in competition and prevent attempts to circumvent the retention.

8. *Enhancing cooperation between national regulators:* The FSF has proposed the creation of international colleges of supervisors and close cooperation between national regulatory authorities. In Europe we are working on the further harmonisation of oversight. We should also rapidly instigate a corresponding process at international level as well.