DRAFT FOR G 20 MEETING

Strengthening the international financial regulatory system

1. Major failures of regulation, plus reckless and irresponsible risk taking by banks and other financial institutions, created dangerous financial fragilities that contributed significantly to the current crisis. A return to the excessive risk taking prevalent in some countries before the crisis is not an option.

2. Since the onset of the global crisis, we have developed and begun implementing sweeping reforms to tackle the root causes of the crisis and transform the system for global financial regulation. Substantial progress has been made in strengthening prudential oversight, improving risk management, strengthening transparency, promoting market integrity, establishing supervisory colleges, and reinforcing international cooperation. We have enhanced and expanded the scope of regulation, with tougher regulation of OTC derivatives, securitization markets and credit rating agencies. We welcome the report to Leaders from the Financial Stability Board, its key role in overseeing this work, and its ongoing efforts to monitor progress which will be essential to the full and consistent implementation of these needed reforms.

3. Yet our work is not done. Far more needs to be done to restore honesty and integrity to markets, promote a race to the top and help ensure the world does not face a crisis of the scope we have seen. We are committed to take action at the national and international level to raise standards together so that our national authorities implement global standards consistently in a way that avoids fragmentation of markets, protectionism, and regulatory arbitrage. We call on our international accounting bodies to achieve a single set of high quality, global accounting standards within the context of their independent standard setting process. Our efforts to deal with impaired assets and to encourage the raising of additional capital must continue. We commit to conduct robust, transparent stress tests as needed. We call on banks to retain a greater proportion of current profits to build capital, where needed, and to support lending.

4. The steps we are taking here, when fully implemented, will help prevent a return to the practices that led to the crisis. If we all act together, financial institutions will have stricter rules for the risk taking, governance that aligns compensation with long-term performance and greater transparency in their operations. Our reform is multi-faceted but at its core must be stronger capital standards. Capital allows banks to withstand those losses that inevitably will come. It, together with more powerful tools for governments to wind down firms that fail, helps us hold firms accountable for the risks that they take. Building on their *Declaration on Further Steps to Strengthen the International Financial System,* we call on our Finance Ministers and Governors to reach agreement on an international framework of reform in the following critical areas:

- *Building high quality capital and mitigating pro-cyclicality*: We commit to improve both the quantity and quality of bank capital and to discourage excessive leverage. The national implementation of higher and higher quality capital requirements, a simple supplemental leverage ratio, counter-cyclical capital buffers, specific liquidity risk requirements and forward looking provisioning as elements of the Basel II capital framework by end-2012 will reduce incentives for banks to take excessive risks and create a financial system better prepared to withstand adverse shocks. We welcome the key measures recently agreed by the oversight body of the Basel Committee to strengthen the supervision and regulation of the banking sector. Our prudential standards for systemically important financial institutions should be commensurate with the costs of their failures.

- *Compensation reform:* Recognizing that excessive compensation policies in the financial sector have both reflected and encouraged excessive risk taking, we commit to reach agreement on global standards critical to financial stability aimed at: aligning compensation with long-term value creation, not excessive risk-taking, including by requiring a significant portion of compensation to be deferred, tied to performance and subject to clawback; and making firms' compensation policies and structures transparent, ensuring that compensation committees act independently and giving shareholders a voice on compensation issues. We support supervisors having the ability to review firms' compensation policies and structures with institutional and systemic risk in mind, and their ability to modify them in the case of firms that fail or require extraordinary public intervention. It is important to reach international agreement by the end-2009 on the elements of compensation structures that are critical to financial stability, while recognizing there are equally important issues for national authorities to address. We welcome the work the FSB has done to set global principles on compensation, emphasizing the need for regulators to discourage excessive risk taking introduced by inappropriate compensation structures, and ensuring robust and consistent implementation. We look forward to the FSB's continued development of a stronger framework for compensation and monitoring of its delivery.

- *Improving over-the-counter derivatives markets*: All standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms and cleared through central counterparties by end-2012. Non-standardized derivative contracts should be reported to trade repositories and, if not centrally cleared, should be subject to higher capital requirements. These actions will improve transparency in the derivatives markets, mitigate systemic risk, and protect against market abuse.

- *Building capacity for cross-border banking resolution by end-2010*: Systemically important financial firms should develop firm-specific contingency plans. Our authorities should establish crisis management groups for the major cross-border firms and a legal framework for crisis intervention as well as improve information sharing in times of stress. We should develop resolution tools and frameworks for the effective resolution of financial groups to help mitigate the disruption of financial institution failures and reduce moral hazard in the future.

5. Our commitment to fight non-cooperative jurisdictions (NCJs) has produced impressive results. We welcome the expansion of the Global Forum on Transparency and the Exchange of Information. We have agreed to deliver an effective program of peer review, capacity building and countermeasures to tackle NCJs that fail to commit to and implement internationally agreed tax standards and stand ready to use countermeasures from March 2010.