

**BASLE/IOSCO JOINT STATEMENT
FOR THE LYON SUMMIT
(May 1996)**

Introduction

The Halifax Summit Review of International Financial Institutions (the Communiqué) identifies issues of critical concern for supervisors and market participants in the financial services sector. Globalisation of capital markets, integration of financial services and the exponential rate of technological and financial innovation, including notably the increased use of derivative products, permit significant enhancements to risk management procedures. They also pose the challenge of potentially greater risk. The ability of markets and their supervisors to respond flexibly to firms' failures and other disruptions is encouraging. Nevertheless, regulators cannot afford to be complacent. Close international cooperation is crucial to continued success in meeting the challenge of the future.

Responding to the challenge

The Basle Committee on Banking Supervision (the Basle Committee) and the International Organisation of Securities Commissions (IOSCO) recognise that the process of globalisation and innovation leads to more efficient allocation of capital and contributes to economic growth. Both organisations share the *common goal of improving the quality of supervision worldwide and responding to financial market developments* in a timely, effective and efficient manner. However, they remain aware that efficient global markets may accelerate the transmission of financial disturbances. The occasional failure of individual market participants is an unavoidable feature of an efficient market system. The ultimate objective of supervision cannot be to avoid all such failures.

In pursuit of their common goal, the Basle Committee and IOSCO have identified the following *eight major principles* which will guide their efforts and which their members agree to promote:

- cooperation and information flows among supervisory authorities should be as free as possible from impediments both nationally and internationally;
- all banks and securities firms should be subject to effective supervision, including the supervision of capital;

- geographically and/or functionally diversified financial groups require special supervisory arrangements;
- all banks and securities firms should have adequate capital;
- proper risk management by the firm is a prerequisite for financial stability;
- the transparency and integrity of markets and supervision rely on adequate reporting and disclosure of operations;
- the resilience of markets to the failure of individual firms must be maintained;
- the supervisory process needs to be constantly maintained and improved.

The Basle Committee and IOSCO are fully resolved to *work actively together*, as they have been doing, to promote these principles. They will anticipate and respond to concerns such as those noted in the Communiqué, albeit determining their priorities in addressing these concerns according to their respective perspectives and responsibilities as banking and securities regulators. Since 1995 a *Coordinating Committee* of representatives of the Basle Committee and IOSCO has been meeting regularly to review what joint work is in train as well as to exchange information on the respective agendas and projects. A *Joint Forum* of bank, securities and insurance supervisors is also continuing the work previously done informally by a Tripartite Group to enhance international cooperation and coordination in the supervision of financial conglomerates.

Completed and ongoing initiatives

In line with the above principles, the work programme of the Basle Committee and IOSCO in the recent past has aimed to establish *concrete international understandings* on safeguards, standards and transparency. The results have included initiatives in the following areas, many of which have been developed jointly:

(a) Internal management control systems. In order to encourage strong *internal management control systems* within the firms, in July 1994, IOSCO and the Basle Committee issued guidance papers concerning risk management of derivatives activities and have since kept this issue under review, in close collaboration with industry groups. Both IOSCO and the Basle Committee are committed to further efforts to encourage financial institutions to implement effective internal control and audit systems.

(b) Capital adequacy. An Amendment to the Basle Capital Accord issued by the Basle Committee this January will allow banks to use the results of proprietary "value-at-risk" models (subject to strict qualitative and quantitative standards) as a basis for measuring the *market risk* element of their regulatory capital requirements. IOSCO has also published papers

on capital standards for securities firms and on the implications of increased use of value-at-risk models by securities firms and is working with the Basle Committee (and a number of major financial institutions) to test such models against a wide range of securities portfolios.

(c) Reporting, disclosure and accounting. With the objective of promoting market transparency, in November 1995 the Basle Committee and IOSCO jointly issued a report on the *Public Disclosure of Trading and Derivatives Activities of Banks and Securities Firms*. Compliance with a common minimum reporting framework identified in a joint report issued in May 1995 (as well as with other quantitative and qualitative disclosure requirements) is being actively monitored and it is expected that standards will continue to evolve rapidly. These efforts complement work being undertaken in other fora, as well as national efforts, to promote market transparency by improving the quality of global market data.

IOSCO is working closely with the International Accounting Standards Committee and the International Auditing Practices Committee to promote the development and implementation of *global accounting and auditing standards* for international securities issuers as alternatives to the use of national standards.

(d) Financial conglomerates. Significant work continues on developing procedures for the effective supervision of *international financial conglomerates*. A discussion paper was published in July 1995, the conclusions of which are now being addressed by the Joint Forum of representatives from IOSCO, the Basle Committee and the International Association of Insurance Supervisors.

(e) Operational and settlement systems. *Cooperation among authorities charged with prudential supervision and payment systems oversight* can strengthen the operational and settlement systems upon which financial markets are based. Effective management of credit and liquidity risks and strong internal controls within banks and securities firms are essential, as are appropriate risk management procedures for netting arrangements, clearing houses, and other settlement systems. Substantial work is being done in these areas, as evidenced by reports of the Basle Committee and the BIS Committee on Payment and Settlement Systems (CPSS) and by the May 1995 *Windsor Declaration* which is being implemented by IOSCO. Future work by IOSCO on selected projects will be undertaken in consultation with the CPSS, and work on bank supervision/payment system issues will continue to benefit from cooperation between the CPSS and the Basle Committee.

(f) Worldwide supervision. The Basle Committee and IOSCO seek to influence supervisory and regulatory policies and procedures *throughout the world*. Both have structures and mechanisms to ensure that their initiatives are communicated to and discussed with financial

institution regulators worldwide. Both also have established procedures to embrace input from market authorities and participants.

(g) Market emergencies. The global market enhances banking and financial markets' sensitivity to crises wherever originated, calling for prompt exchange of information and immediate, coordinated action among relevant authorities. Banking and securities supervisors continue to develop contact and communication procedures to *strengthen their ability to react effectively* at times of market emergencies.

Strengthening cooperation between the regulators of diversified financial groups

The collaborative efforts described above address key elements in supervision and regulation and represent positive developments in the overall regulatory and operational framework. In light of the evolving market place and the risks associated with new trends in global trading, the Basle Committee and IOSCO continually review supervisory practices and procedures in order to ensure that these remain effective and that supervisors are in a position to deal with market disruptions should they occur. A particular concern is to develop satisfactory arrangements for oversight of *diversified financial groups* which offer a wide range of financial services on a global basis. The two organisations are resolved to foster arrangements that promote:

- an improved understanding of the roles, powers and responsibilities of the different regulators of such groups;
- access by each regulator of such a group directly or through a coordinating authority to the information needed to fulfil its responsibilities, including making meaningful assessments of the risks to the relevant entities within the group and to those entities taken together; and
- communication lines that will maintain and enhance regulators' abilities to react to market developments in a timely and effective manner.

The Basle Committee and IOSCO have therefore agreed to pursue a *joint initiative* to promote additional cooperative and collaborative arrangements, including effective lines of communication, in the supervision of diversified financial groups. It will build on the ongoing efforts of banking and securities regulators on a national, bilateral and multilateral basis, as described above. The principal focus of this initiative will be:

- the types of groups or institutions for which such arrangements would be useful and appropriate;

- the types of information that may need to be exchanged;
- ways to facilitate the resolution of possible legal, confidentiality, policy or practical issues that may arise; and
- any additional arrangements that may be appropriate to coordinate the activities of the relevant supervisors.

A particular aspect of this initiative will be to consider the need for and feasibility of *additional coordinating arrangements* in order, for example, to facilitate the exchange of information between the relevant regulators of the group, both in normal and emergency situations. This exercise will support the work of the Joint Forum of banking, securities and insurance supervisors and the practical arrangements will be consistent with the Joint Forum's mandate. In addition, the exercise may need to consider the extent to which existing provisions of national law (for example, existing secrecy legislation which in some jurisdictions restricts the ability of regulators to share information) interfere with the achievement of desirable supervisory objectives; the members of IOSCO and the Basle Committee are prepared to assist Ministers in addressing such legal concerns.

The joint Basle/IOSCO initiative is aimed at promoting more effective cooperation between banking and securities regulators, and will *enhance the ability of regulators* to fulfil their responsibilities more effectively. It should be emphasised, however, that any arrangements to improve coordination and cooperation at the international level will not in any way reduce the powers and responsibilities of any authority that is responsible for regulation of the different parts of a group as defined in national law.

Conclusion

The Basle Committee and IOSCO appreciate the opportunity to provide the G-7 Finance Ministers with this review of their current work programmes and arrangements to strengthen cooperation. Although the work has been demanding, progress has been substantial. Indeed, these initiatives are required to keep pace with the evolution of capital markets and the international financial services sector. Looking forward, both organisations are *committed to increasing the effectiveness of banking and securities supervision* without stifling innovation and efficiency.

