

Structural and regulatory developments

Initiatives and reports concerning financial institutions

April

BCBS releases its
1999 survey of
public disclosures

The Basel Committee on Banking Supervision (BCBS) released the results of its 1999 survey of public disclosures by banks. The survey forms part of ongoing efforts by the BCBS to promote effective market discipline in banking and capital markets through improved public disclosure.¹ As in previous years, it reviews the disclosure of both quantitative and qualitative information contained in the public reports of banks. The results show varying disclosure levels in the areas surveyed. Banks commonly disclosed capital-related items, credit risk allowances, diversification of credit risk and accounting policies. However, there was a lack of disclosure in areas related to credit risk modelling and the use of internal and external ratings. Disclosure was also lacking in the area of derivatives and securitisation.

Working group on
disclosure issues
recommendations

The Multidisciplinary Working Group on Enhanced Disclosure, a grouping sponsored by four international bodies with financial sector responsibilities,² issued a report recommending improvements to the disclosure practices of financial intermediaries worldwide.³ The report, which is based on data collected from 44 financial institutions in nine countries, recommends inter alia that disclosures be consistent with firms' internal risk management practices. They should include: (a) intraperiod high, median and low, and period-end value-at-risk (VaR) of actively managed or marked-to-market exposures; (b) substantive qualitative discussion of funding liquidity risk; and (c) information about credit exposures broken out by type of exposure or business line, credit quality and maturity. In addition, the report notes that quantitative information

¹ Improved disclosure is also proposed as the third pillar of the new Basel Capital Accord, along with minimum capital requirements and the supervisory review process.

² The Basel Committee on Banking Supervision (BCBS), the Committee on the Global Financial System of the Group of Ten central banks (CGFS), the International Association of Insurance Supervisors (IAIS) and the International Organization of Securities Commissions (IOSCO).

³ See *Final Report of the Multidisciplinary Working Group on Enhanced Disclosure*, BCBS, CGFS, IAIS and IOSCO, Basel, April 2001.

on certain areas, such as liquidity risks, would fill an important gap in financial disclosures. Nevertheless, it argues that further development of risk assessment concepts and methods would be necessary before a judgment could be reached on such disclosures.

The European Commission presented a proposal for a Directive that would introduce group-wide supervision of financial conglomerates. The proposal, which would require closer cooperation among supervisory authorities across sectors, would align the rules for financial conglomerates with those for homogeneous financial groups so as to ensure equivalence of treatment. The proposal was prompted by continuing consolidation in the European financial services industry.

European Commission proposes Directive on financial conglomerates

May

The BCBS released a document discussing risk management principles for electronic banking.⁴ Judging that detailed risk management requirements in the rapidly evolving area of e-banking might be counterproductive, the Committee expressed its guidance in the form of broad guidelines. It identified 14 principles to help banking institutions expand their existing risk oversight policies and processes in e-banking activities.

BCBS releases risk management principles for e-banking

A BCBS Working Group on Cross-Border Banking, which included selected members of the Offshore Group of Banking Supervisors, prepared a statement of mutual cooperation between banking supervisors setting out the essential reference elements for bilateral relationships between banking supervisory authorities in different countries (and, where appropriate, between banking supervisors and other financial regulators).⁵ The statement is intended to provide a framework for an agreement between supervisors, leaving sufficient discretion and flexibility for additional details and responsibilities if they so wish.

BCBS working group proposes framework for mutual cooperation between supervisors

The European Union's Council of Ministers and the European Parliament adopted a Directive to modernise EU accounting rules by introducing "fair value" accounting methods. The Directive amends the European Union's Accounting Directives to take account of market developments and new international accounting standards, making it easier for European companies raising capital worldwide to comply with financial reporting requirements in international capital markets. Although banks are included in the scope of the Directive, the Commission stated that the Directive was not about the introduction of "full" fair value reporting, a concept that it will eventually analyse on its own merits.

European Union adopts Directive modernising accounting rules

⁴ See *Risk management principles for electronic banking*, BCBS, Basel, May 2001. Available at www.bis.org.

⁵ See *Essential elements of a statement of cooperation between banking supervisors*, BCBS, Basel, May 2001. Available at www.bis.org.

June

BCBS announces
new timetable for
New Basel Capital
Accord

The BCBS announced a revised timetable for completion and implementation of the New Basel Capital Accord. The Committee will release a complete and fully specified proposal for an additional round of consultations in early 2002 and will finalise the New Accord during 2002. Accordingly, the BCBS envisions an implementation date of 2005 for the New Accord. The timetable was amended to allow the Committee to deal with the large number of comments received and to cooperate with the industry in achieving the best possible proposals. The BCBS highlighted several important decisions that it had taken with respect to the proposals. First, the Committee remains strongly committed to the three pillars architecture of the New Accord and to the broad objective of improving the risk sensitivity of capital requirements. Second, it reiterates its objective of maintaining an equivalent level of regulatory capital for the average bank under the revised standardised approach and its view that incentives between the standardised and internal ratings-based (IRB) approaches should encourage banks to adopt the more advanced approaches to credit risk. In particular, the Committee anticipates the need for reductions in the basic calibration of the foundation IRB approach, for both corporate and retail portfolios. Third, it notes that the target capital ratio for operational risk (20%) would be reduced in line with the view that it reflects too large an allocation of capital to this risk. Fourth, it believes that further efforts are needed to ensure that the new proposals deliver an appropriate treatment of credit exposures to small and medium-sized enterprises (SMEs). This is likely to lead to lower capital for SME lending compared to the January 2001 proposals.

Canada reforms its
financial sector

The government of Canada introduced legislation reforming the country's financial sector. One of the key features of the legislation is a new definition of "widely held banks" that permits an investor to own up to 20% of any class of voting shares and 30% of any class of non-voting shares subject to a "fit and proper" test. This change would allow banks to engage in substantial share exchanges, including the ability to enter into strategic alliances and joint ventures.⁶

Initiatives and reports concerning financial markets and their infrastructure

April

ISDA announces
new documentation
for credit swaps ...

The Credit Derivatives Market Practice Committee of the International Swaps and Derivatives Association (ISDA) announced that it had reached a consensus on how to address documentation issues arising from debt restructurings under credit default swaps. A framework, including a supplement to the 1999 Credit Derivatives Definitions, was presented by ISDA at its Annual

⁶ However, the Canadian Bank Act will continue to prohibit control of a large financial institution by any single shareholder or group of shareholders.

General Meeting in Washington, D.C. The new approach will allow for credit swaps to be traded both with and without restructuring clauses. For credit swaps including restructuring, the new provisions would, in certain circumstances, limit the maturity of the obligations that are deliverable after the occurrence of a restructuring, thereby limiting the “cheapest-to-deliver” option that has caused problems following recent restructuring events. They would also require all deliverable assets to be fully transferable and to include a pari passu provision requiring a protection buyer to deliver an obligation of the same seniority as the one on which the protection was originally written. The new framework should better shield sellers of protection in the event of a restructuring by safeguarding the value and transferability of deliverable assets under physically settled default swaps (the standard delivery procedure in that market). It should also restore liquidity to the credit default swaps market. With restructuring having been tackled, ISDA said that it was turning to remaining documentation issues, such as the question of the successor entity in the event of a firm’s break-up.

... which limits the maturity of deliverable assets

May

The European Commission presented a proposal for a Directive on insider dealing and market manipulation. The proposal would improve standards for market integrity in the securities field throughout the European Union. It would also reduce potential inconsistencies and loopholes by establishing a basic framework for the allocation of responsibilities, enforcement and cooperation within the European Union. The European Commission also proposed a Directive introducing a new “single passport for issuers” so that, once a prospectus has been approved by the home country authority of the issuer, it would have to be accepted throughout the European Union for public offer and/or trading on regulated markets. The proposed Directive would simplify the submission of prospectuses and make it easier to raise capital throughout the European Union. These are the first two proposals for Directives to be submitted under the streamlined legislative process recommended by the Committee of Wise Men on the Regulation of European Securities Markets in February 2001, which distinguishes broad framework principles from detailed technical implementation (see below).⁷

European Commission proposes Directive on insider dealing and market manipulation ...

... and another on a single passport for issuers

The US Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) announced proposals for joint rules in implementing new statutory provisions relating to securities futures. The Commodity Futures Modernization Act of 2000 (CFMA) lifted the ban on futures contracts on single stocks and narrow-based securities indices. It also established a framework for the joint regulation of securities futures by the CFTC and the SEC. While futures contracts on broad-based indices are under the exclusive jurisdiction of the CFTC, the joint rules proposed by the CFTC

US CFTC and SEC announce joint rules for securities futures

⁷ See also the box on page 69 of the June 2001 issue of the *BIS Quarterly Review* for a summary of the report.

and the SEC relate to the distinction between broad and narrow-based securities indices.

June

FATF updates its list of non-cooperative countries

The Financial Action Task Force on Money Laundering (FATF) published its 12th annual report.⁸ The document updates the list of “non-cooperative” countries and territories first published in June 2000, removing the Bahamas, the Cayman Islands, Liechtenstein and Panama following the adoption of significant reforms by those countries.⁹ It also recommends the application of additional countermeasures (including the possibility of enhanced surveillance and reporting of financial transactions) as of 30 September 2001 with respect to Nauru, the Philippines and Russia unless their governments enact significant legislation addressing money laundering concerns.

European Commission creates two committees for securities markets

Following the recommendations of the Committee of Wise Men on the Regulation of European Securities Markets, the European Commission created a European Securities Committee (ESC) and a Committee of European Securities Regulators (CESR). The two advisory Committees will play a crucial role in assisting the European Commission in implementing the Financial Services Action Plan (FSAP) and speeding up the legislative process. The ESC will be composed of high-level representatives of member states. It will advise the European Commission on issues relating to securities policy. At a later stage, when implementing powers are devolved to it through a co-decision procedure, it will also act as a regulatory committee. The CESR was set up as an independent advisory body composed of representatives of the national authorities competent in the field of securities markets. It will advise the European Commission on the technical details of securities legislation. It will also help enhance cooperation between supervisory authorities so as to ensure more consistent day-to-day implementation of EU legislation in the member states.

FESCO publishes proposals for ATSS

The Forum of European Securities Commissions published proposals for common European standards for alternative trading systems (ATSS). The need for new standards arises from the fact that existing rules for the conduct of business do not fully address the particular risks posed by the specific nature of services provided via ATSS. The standards aim to ensure that users of ATSS are adequately protected and that market integrity is ensured, concentrating on the areas of authorisation/registration, transparency, reporting rules, and prevention of market abuse.

US SIA endorses best practice code for research analysts

The US Securities Industry Association endorsed a compilation of best practices to be followed by brokerage firms to ensure the integrity of securities research and analysis. The best practices were compiled by a committee of senior research professionals from the Association's 14 largest firms. The guidelines come in response to public criticism of the integrity of firms'

⁸ The FATF is an independent international body and its secretariat is housed at the OECD.

⁹ See the August 2000 issue of the *BIS Quarterly Review* for a more detailed treatment.

research and concern that the work of analysts is subordinated to the need to win underwriting mandates or corporate finance business. They address all aspects of the role of research departments within firms to ensure that research is objective, independent and of the highest integrity. Key recommendations of the report include that: research departments should not report to investment banking or any other business units that might compromise their independence; analysts should be encouraged to indicate both when a stock should be bought and when it should be sold; analysts should not trade against their own recommendations and should disclose their holdings in companies they cover; and analysts' pay should not be directly linked to investment banking transactions, sales, and trading revenues or asset management fees.

The CFTC announced that it had approved the application of BrokerTec Futures Exchange, LLC, for designation as a contract market. BrokerTec said that it would introduce futures on US Treasury notes in the third quarter of 2001. The Commission made the approvals under the Commodity Exchange Act, as amended by the CFMA. The new Act facilitates the establishment of contract markets in securities futures by national securities exchanges, national securities associations, or alternative trading systems.

US CFTC approves new type of futures market

Eurex, the German-Swiss derivatives exchange, introduced position limits for the September 2001 contracts in capital market futures. This measure was aimed at supporting the early rollover of open positions into the next contract cycle. The position limits, which were set in relation to the issue size of the cheapest-to-deliver bond, apply to long positions held by market participants (separated according to proprietary and customer trading positions). As an additional change favouring the flexibility of securities delivery, Eurex reduced the penalty for late deliveries in certain settlement cycles.

Eurex introduces position limits on certain futures

Representatives of Spain's stock and derivatives exchanges, and of their clearing and settlement systems, signed an accord creating a new unified holding company to be known as Bolsas y Mercados Españoles. Creation of the holding company will require legislation and valuation of the separate entities. The holding company will eventually seek a stock market listing and perhaps seek an alliance with other European exchanges.

Spanish stock and derivatives exchanges unify their markets

Chronology of major structural and regulatory developments		
Month	Body	Initiative
April 2001	Basel Committee on Banking Supervision	Releases the results of its 1999 survey of public disclosures by banks
	Multidisciplinary Working Group on Enhanced Disclosure	Issues a report recommending improvements to the disclosure practices of financial intermediaries
	European Commission	Presents proposals for a Directive on group-wide supervision of financial conglomerates
May 2001	International Swaps and Derivatives Association (ISDA)	The Credit Derivatives Market Committee of ISDA announces a framework for debt restructurings under credit default swaps
	Basel Committee on Banking Supervision	Releases a document discussing risk management practices in e-banking
	Working Group on Cross-Border Banking of the Basel Committee on Banking Supervision	Releases a proposed statement on mutual cooperation between banking supervisors
	EU Council of Ministers and European Parliament	Adopt a Directive to modernise EU accounting rules
	European Commission	Proposes Directives on (i) insider dealing and market manipulation, and (ii) single passport for issuers
June 2001	US Commodity Futures Trading Commission and US Securities and Exchange Commission	Announce proposals for joint rules relating to securities futures trading
	Basel Committee on Banking Supervision	Announces a revised timetable for completion and implementation of the new Basel Capital Accord
	US Securities Industry Association	Endorses best practice code for research and analysis by brokerage firms
	Government of Canada	Introduces legislation reforming the country's financial sector
	Financial Action Task Force on Money Laundering	Updates its list of non-cooperative countries in its fight against money laundering
	European Commission	Creates a European Securities Committee and a Committee of European Securities Regulators
	Forum of European Securities Commissions	Publishes proposals for common European standards for alternative trading systems
	US Commodity Futures Trading Commission	Approves the application of BrokerTec Futures Exchange as a US contract market
	Eurex	Introduces position limits for capital market futures and reduces the penalty for late delivery of securities
	Spanish stock and derivatives exchanges	Sign an accord creating a new unified holding company