The international financial crisis

Norway's key messages for the G20

Enhancing sound regulation and strengthening transparency (WG1)

General comments:

- **The international financial crisis has disclosed flaws in regulation and supervision in several countries, and clear weaknesses have been brought to light in financial institutions' risk management.** The global integration of financial markets has enabled problems arising in one market segment to spread rapidly through several channels to become a global crisis and has later had substantial negative impact on the economy as a whole. Improved methods are needed to monitor financial stability. There is also a need for a better understanding of the mechanisms whereby risk spreads between markets and between countries and for assessments of actions taken by governments when risks are identified.

Key measures:

1. The financial crisis has its origin in the creation of financial products and financial institutions that escaped market regulation and capital requirements. These unregulated markets expanded rapidly to make up a substantial portion of the financial sector prior to the crisis. An overriding aim must be to ensure that the entire financial sector is subject to regulation and supervision.

2. All regulation has its price. This price is, however, to be regarded as an insurance premium against insolvencies and crises in financial markets and negative impacts on the wider economy. We must ensure that the entire financial sector is covered by relevant regulation and that regulation between different segments of the marked is mutually consistent (based on the principle of 'same risk, same regulation').

3. The recommendations under Basel II and rules in corresponding EU directives must be reviewed in the light of the experiences from the financial crisis. The aim should be to foster an efficient regulatory and supervisory system. A crucial element will be to dampen the financial system's procyclical mechanisms, and to require higher quality of capital. More generally Norway strongly supports all work, including work in EU, to get better regulation and supervision (cf. par. 1 and 2 above)

4. It is important to focus more on crisis management, on measures to prevent them arising, and on financial institutions engaged in cross border activities through

branches in other countries. While legally speaking part of the parent institution, branches may be of such size and complexity as to constitute an important part of the financial system in the country in which they are established (host country). Consideration should be given to allowing host countries to require conversion of system-important foreign branches to subsidiary status.

5. It is important to have in place an accounting framework that promotes a transparent view of the actual situation in financial institutions. Accounting rules should at all times give as correct a view as possible of institutions' financial status, and avoid procyclicality. In this connection, it is important to view accounting rules and capital requirements in conjunction.

6. Rating agencies should be subject to regulation and supervision. They should refrain from rating complex products for which they lack sufficient information to properly assess the products' credit quality.

7. Supervisory authorities should see to it that financial institutions do not employ remuneration systems (including commission systems) likely to encourage risk taking that is inconsistent with long-term sustainability. Remuneration based on share value should be avoided.

Reinforcing international cooperation and promoting integrity in financial markets (WG2)

General comments:

- **The global financial system is vulnerable to countries with weak regulation and supervision**. The need for increased international cooperation on supervision and regulation of financial markets seems obvious. Work to this end should take place across many different forums. It is important that the final outcome should be an improved regulatory regime that is binding on all market entities.

Key measures:

8. It is important that the recommendations produced by the G20 process are directed into and rooted in the multilateral system in institutions with a broad country representation, e.g. the IMF.

9. Tax havens' secrecy rules may weaken global financial stability. International cooperation against tax havens' secrecy needs to be strengthened, both within the OECD and through other channels.

10. Its important that the Santiago Principles for SWFs, and the OECD guidance for recipient countries, are followed up as soon as possible by home countries and host countries alike.

11. Protectionism and trade war must be avoided. Weaknesses and loopholes in WTO rules must not be used to introduce measures that in effect are trade barriers: WTO negotiations must be concluded as soon as possible.

IMF reform (WG3)

General comments:

- With its broad competence, political foundation and established surveillance of member countries, **it is natural that the IMF should have a stronger role** in the surveillance of the financial markets.

Key measures:

12. IMF competence and work on financial market issues should be strengthened. The IMF should serve as an arena for cooperation on, and exchange of best practice for, supervision and regulation of financial market institutions.

13. Financial market issues should be given a more prominent role in the IMF's bilateral and multilateral surveillance. Issues of systemic importance should be given particular emphasis. IMF surveillance of the financial sector in member countries should be strengthened, both through FSAPs[1] and through regular Article IV consultations. For the global financial stability, such consultations with major member countries are of particular importance. FSAPs should be made obligatory.

14. The IMF should be reluctant to take on a role in concrete regulatory development. Responsibility for technical tasks of this nature should remain with the BIS. Cooperation between the IMF and BIS should be strengthened either directly or through the FSF[2].

15. Cooperation between the IMF and FSF should be strengthened to prevent future crises. The work of the FSF should be incorporated to a greater extent into the activity of the IMF in order to add breadth and thrust to the work on financial stability.

16. The FSF's membership should be expanded to increase its legitimacy.

17. The adopted reform of quotas and voting rights will make the IMF more democratic and strengthen its legitimacy. Further governance reforms need to be implemented to give developing countries more influence and to put the institution in a better position to prevent international crises.

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[1] The Financial Sector Assessment Program (FSAP) was established by the IMF and the World Bank to assess the implementation of various standards in the financial sector.
[2] The Financial Stability Forum was established in 1999 to promote information exchange and cooperation on financial oversight and supervision. 11 countries and 12 international institutions are members of the FSR.

18. An open, merit-based and transparent process should be applied to select top IMF managers, based on objective criteria and with no geographical preference.

19. Steps should be taken to ensure that the IMF is capable of meeting borrowing needs that might arise in the current crisis. Norwegian authorities are exploring a possible Norwegian contribution of financial resources to the IMF to that end.

Reform of the multilateral Development Banks (WG4)

General comments:

- **In the current economic crisis, the role of the Multilateral Development Banks (MDBs) in helping developing countries to gain *access* to finance is vital.** Capital flows to developing countries are now declining considerably, and the MDBs (and the IMF) are among the very few institutions that will substantially *increase* their lending and capital flows to developing countries. We are therefore prepared to review the potential need for capital increases on a case-by-case basis - within each Bank's own governance structure.

- **The current mandates of the MDBs are sufficiently *broad* to alleviate adverse effects of the crisis in both middle-income and low-income countries.** Poverty reduction and long-term development should remain the core mandate of the MDBs.

Key measures:

20. General conditionality should be reduced to a minimum, providing more policy space to developing countries to shape their own economic policy.

21. An open, merit-based and transparent process should be applied to select top World Bank managers, based on objective criteria and with no geographical preference.

22. The voice and representation of developing and transition countries, in particular the least developed countries, in the World Bank should be strengthened.

23. The current reform process should also be used to strengthen collaboration between MDBs and the UN funds and programmes.

24. Tasks and resources assigned to the MDBs must be adequately matched. It is important that previous commitments made to MDBs by several G20 countries are honoured, including commitments to compensate the MDBs for costs relating to the HIPC and MDRI initiatives. Continued efforts in the areas of gender equality, health, education and safety nets are important.

25. Some form of temporary debt moratorium could be considered for especially hard hit countries (similar to what Indonesia received after the Tsunami). MDBs' current mandates are sufficient. Poverty reduction and long-term development should remain the core mandate of the MDBs. Emphasis should also be given to gender equality, health, education and social safety nets.

26. Additional governance reform of the MDBs should continue to be dealt with in their governing bodies, where all member states are represented.