Priorities for the Reform of Global Regulation

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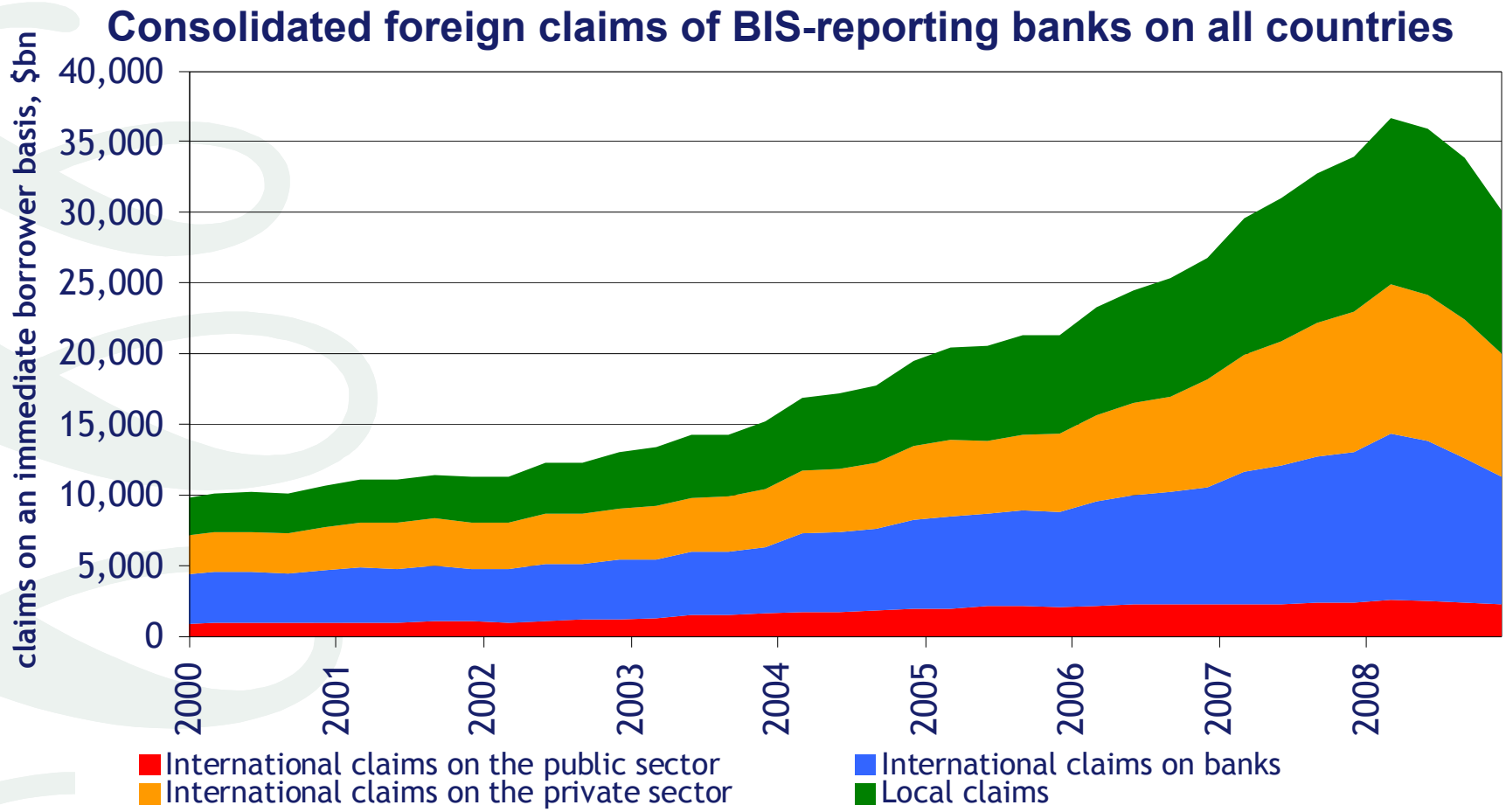
IOSCO
Tel Aviv, 11th June 2009

FSA

"There is growing recognition that the dispersion of credit risk by banks to a broader and more diverse set of investors, rather than warehousing such risk on their balance sheets, has helped make the banking and overall financial system more resilient."

IMF Global Financial Stability Report, April 2006

Growth in bank cross-border claims



Note: Local claims include local currency claims of reporting banks' foreign offices on local residents. International claims include cross-border claims in all currencies plus non-local currency claims of banks' foreign offices.

Source: Bank for International Settlements

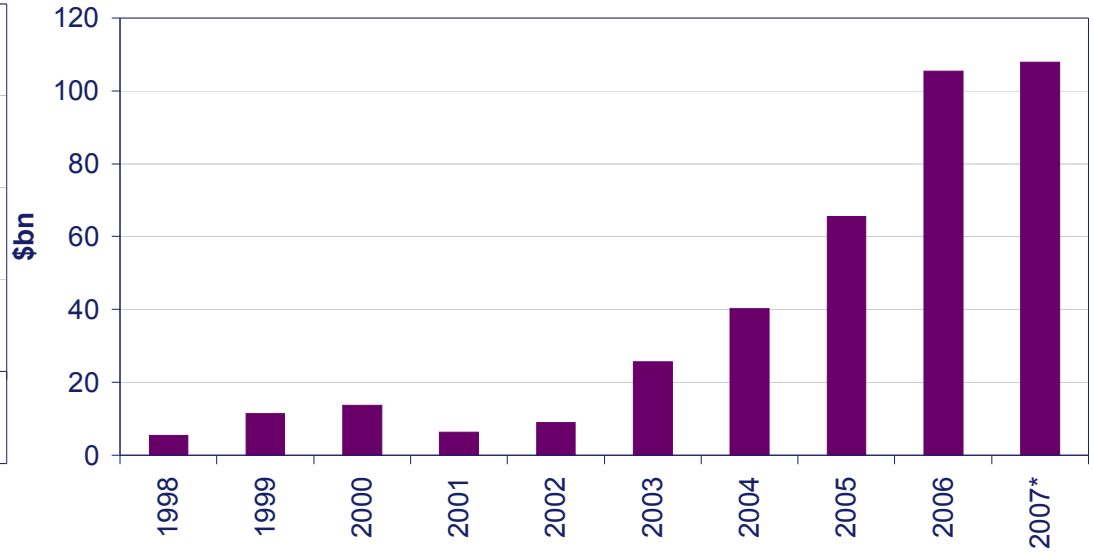
Securities inflows into emerging economies

Growth in outstanding amounts of international emerging market debt

Note: Figures for 2005 exclude Argentine debt restructuring.

Source: Bank of International Settlements, FSA Calculations

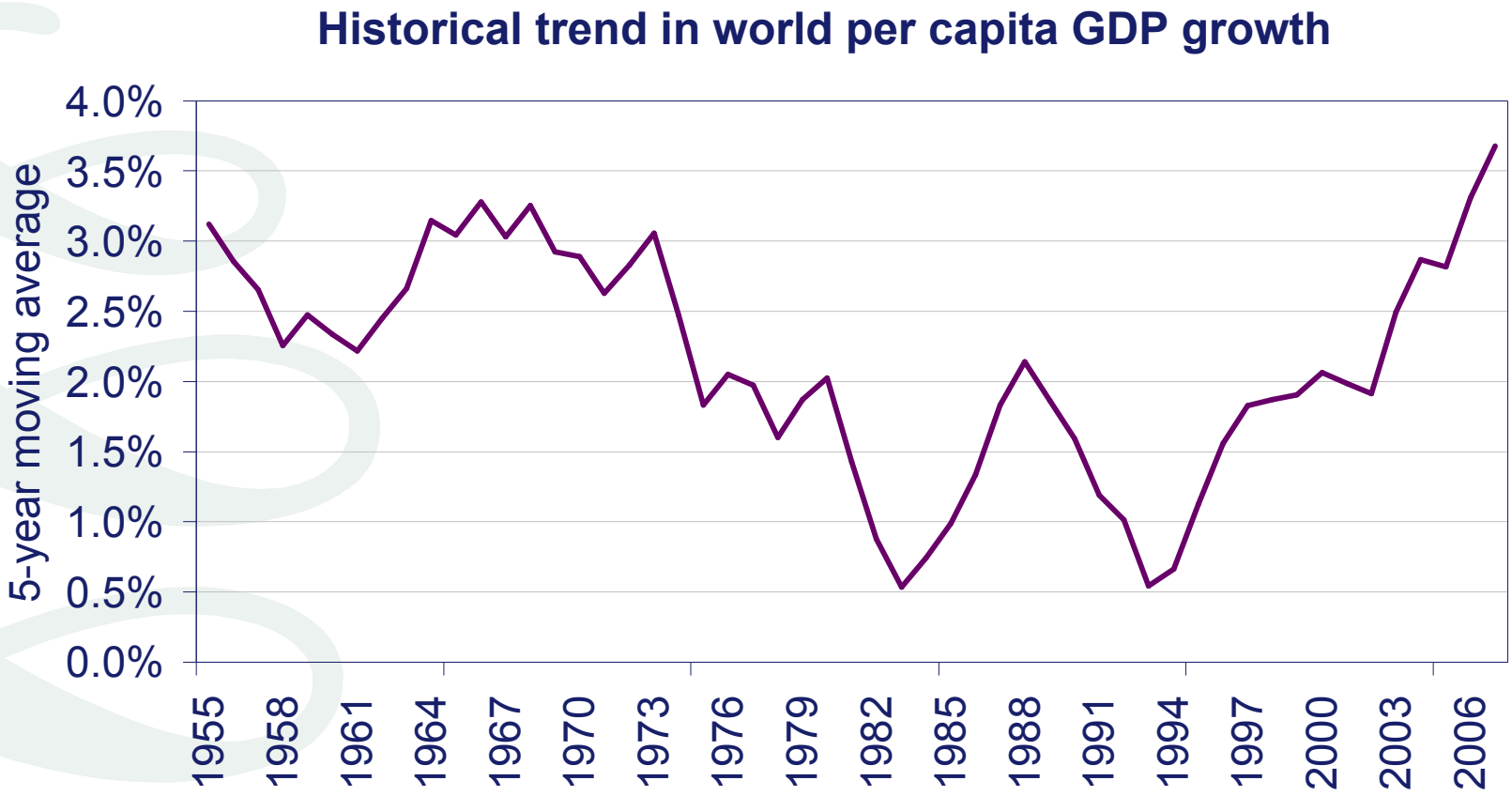
Inflows of portfolio equity investment in emerging economies



Note: Due to the delays in reporting to the IMF, estimated figures have been used for India in 2007

Source: IMF, FSA calculations

Global growth



Source: Angus Maddison, Historical Statistics of the World Economy: 1-2006 AD; IMF; FSA Calculations

Revisions to the IMF Forecasts for Japan

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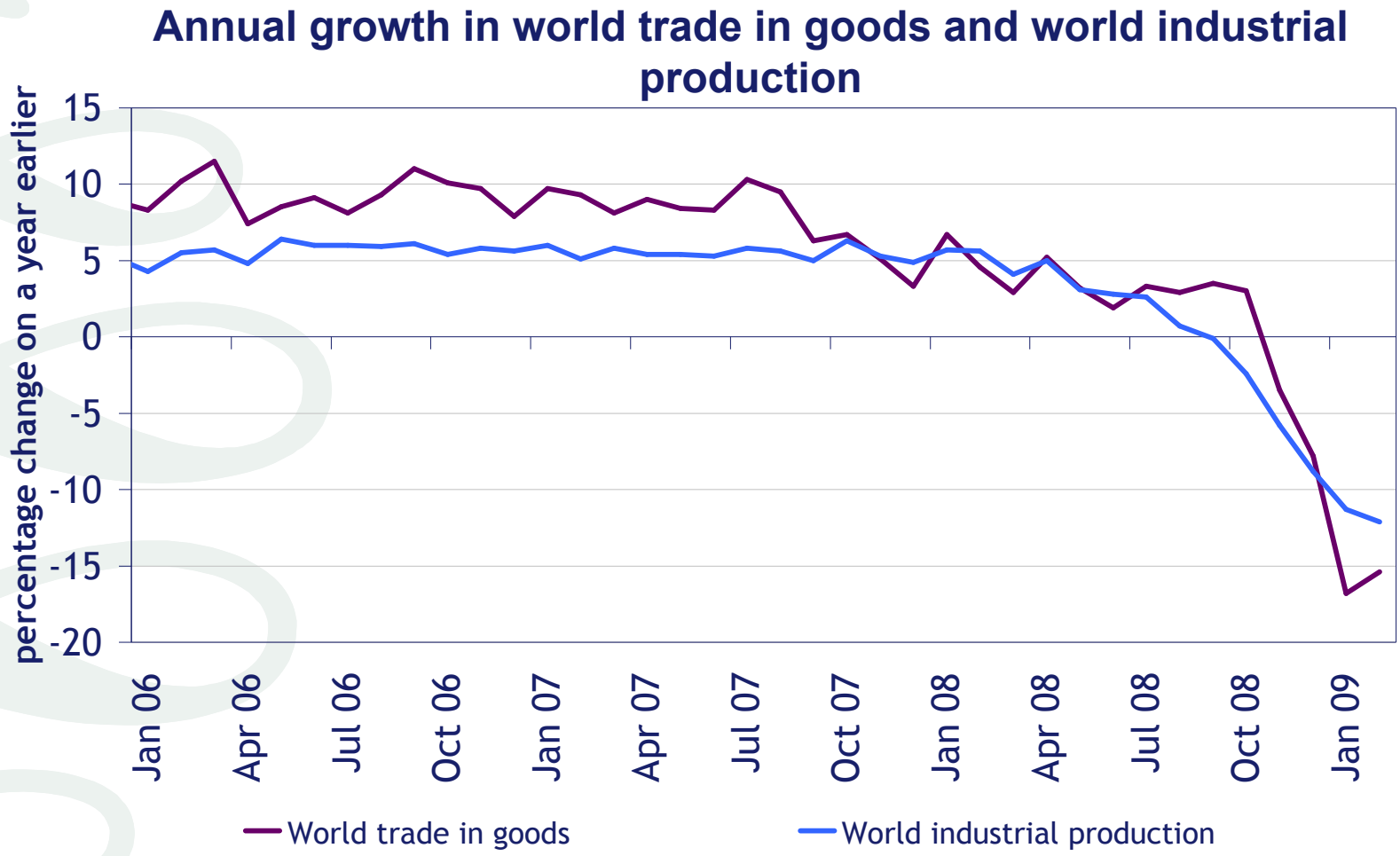
Publication date	Forecast for Japan GDP growth in 2009
April 2008	1.5%
July 2008	1.5%
October 2008	0.5%
November 2008	-0.2%
January 2009	-2.6%
April 2009	-6.2%

Source: IMF World Economic Outlook

Collapse in world trade in goods



Source: Bank of England

Outflows of bank capital, by region

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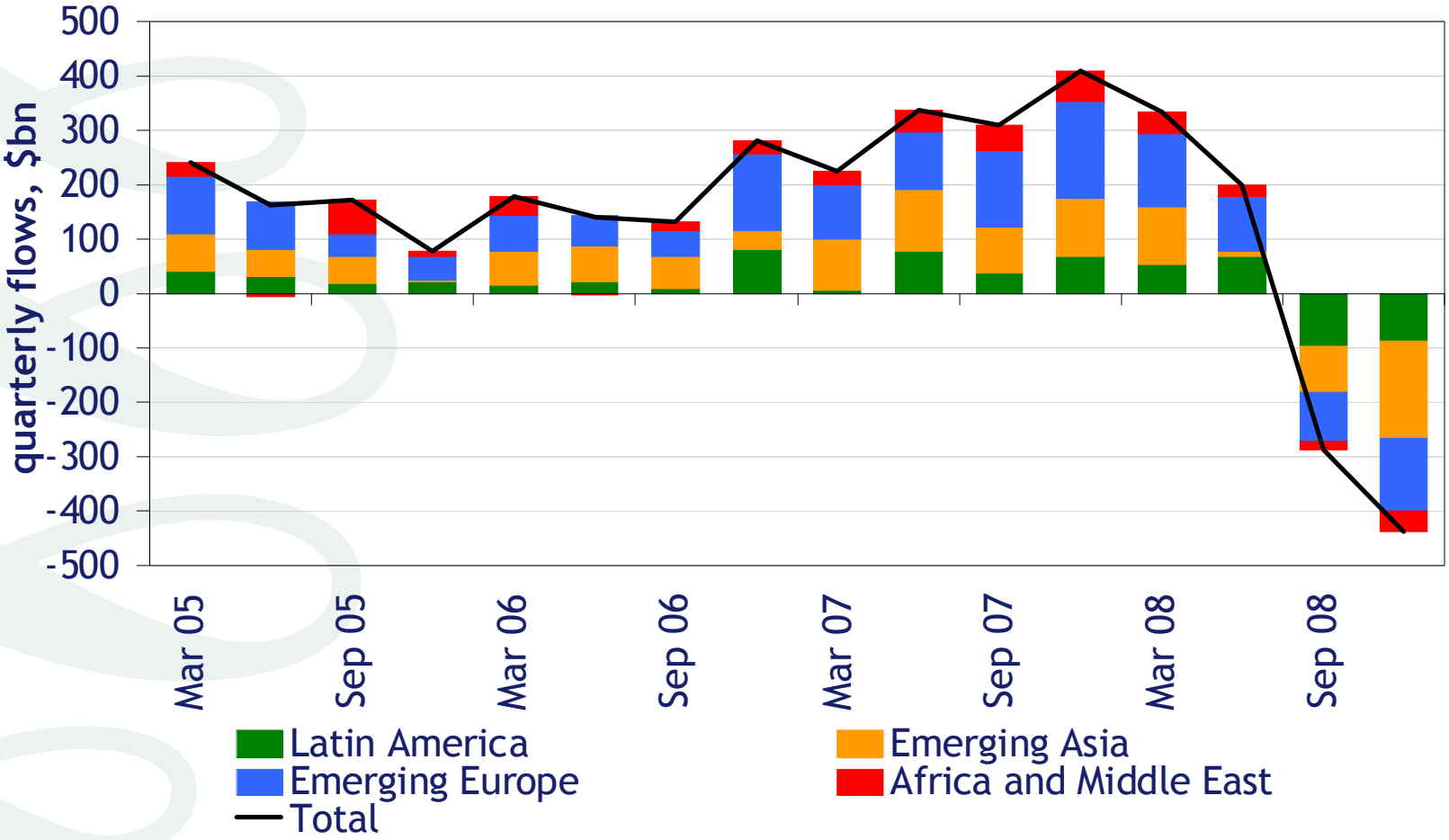
Changes in the BIS bank claims on the emerging market economies, by region

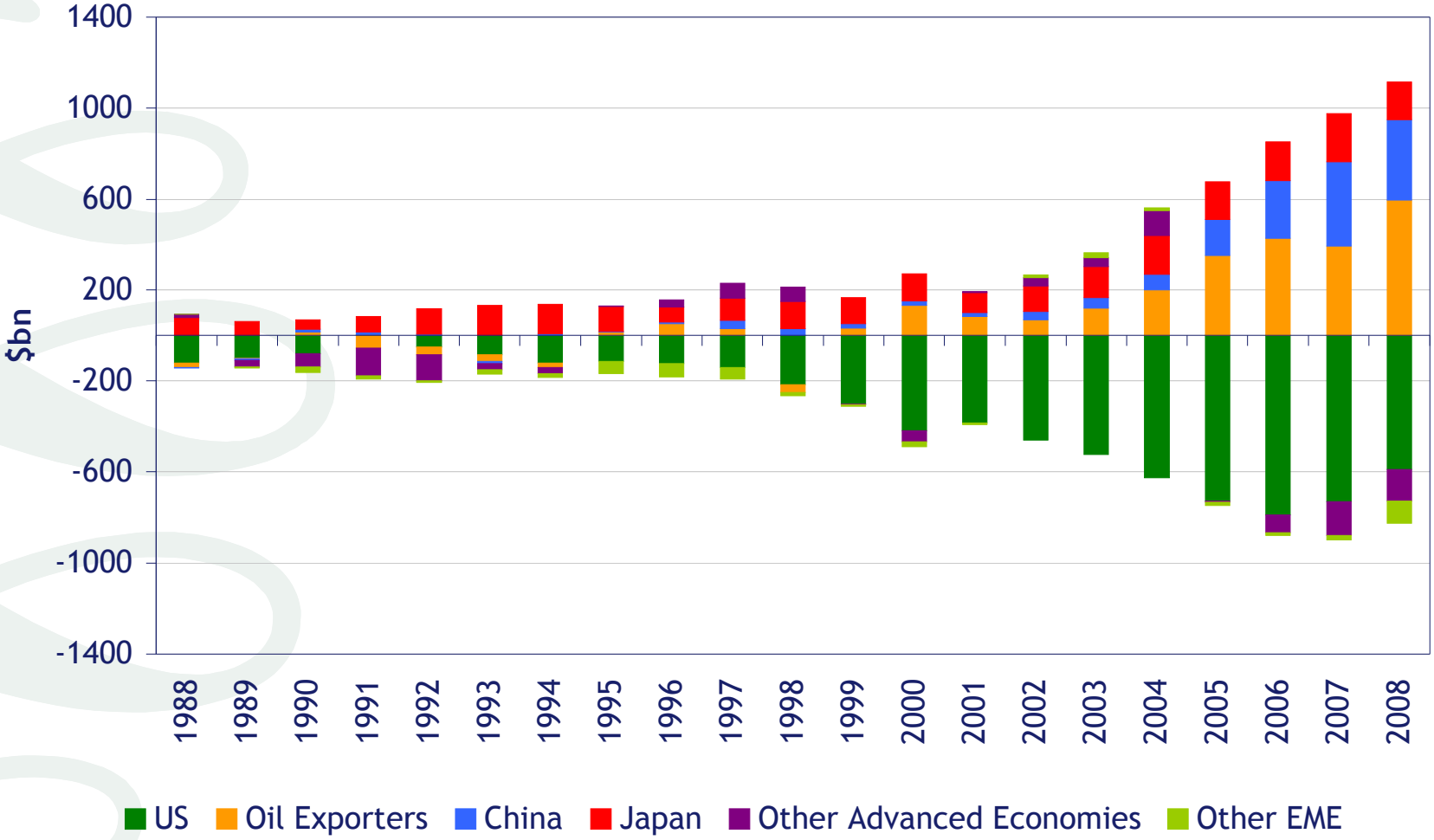


Source: Bank for International Settlements

Six drivers of the crisis

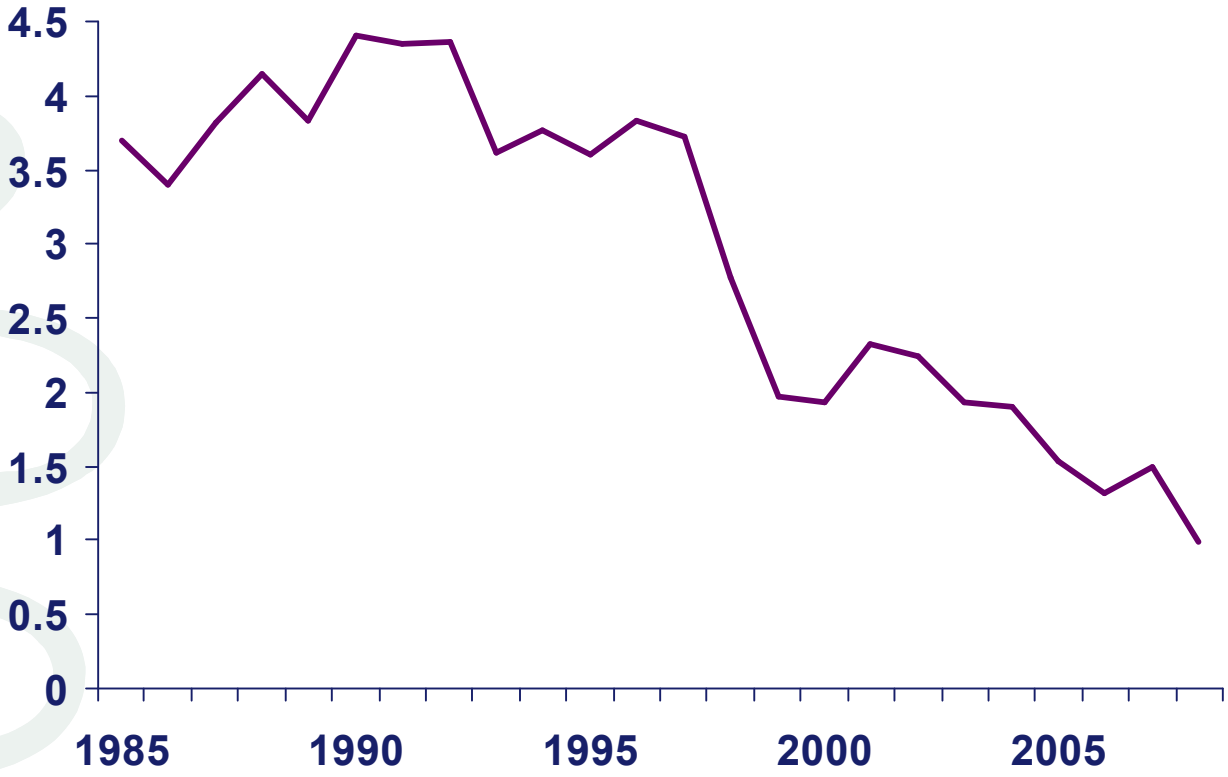
- Macro-economic imbalances
- Financial innovation
- Increased leverage
- Increased and changed forms of maturity transformation
- Changing nature of securitised credit model
- Irrational exuberance and then despair

Global current account imbalances



Source: IMF, FSA calculations

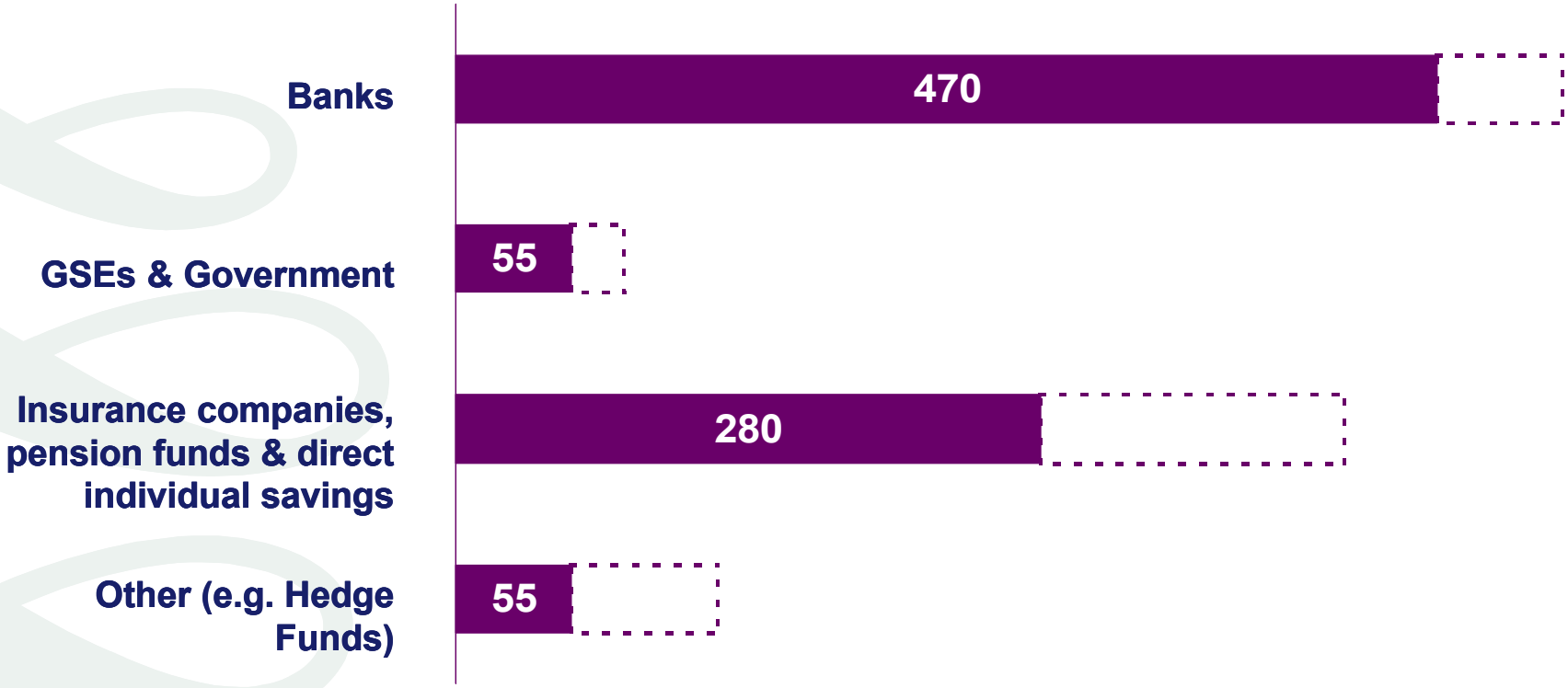
UK real interest rates



Note: For the years 1985, 86, 89, 90 & 91 no 20 year yield is precisely available; the longest available yield (in range 16-19 years) is shown

Source: Bank of England Real Yield curve calculations

Estimates of mark-to-market losses



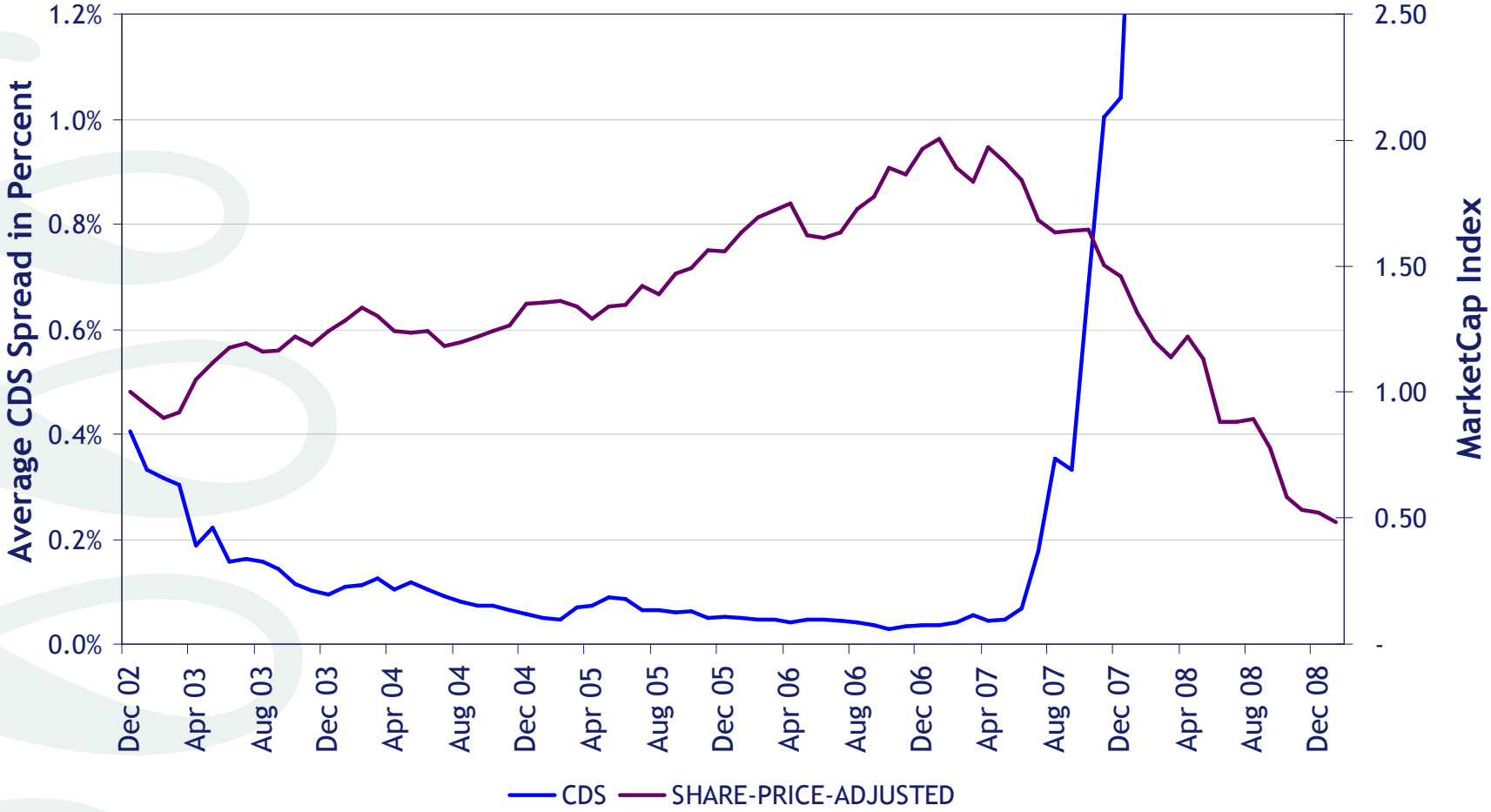
Note: Estimates based on US credit securities at October 2008

Source: IMF Global Financial Stability Report, October 2008

Three theoretical considerations

- Efficient markets not necessarily rational
- Market irrationality more harmful in some markets than others
- Much financial innovation not socially useful

Share prices and CDS spreads of major banks



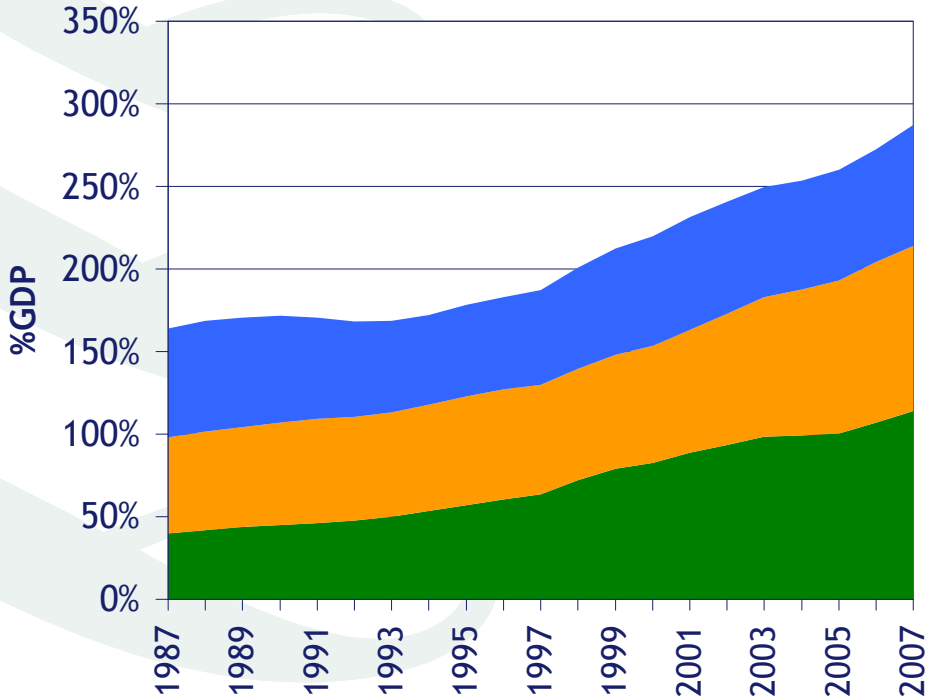
Firms included: Ambac, Aviva, Banco Santander, Barclays, Berkshire Hathaway, Bradford & Bingley, Citigroup, Deutsche Bank, Fortis, HBOS, Lehman Brothers, Merrill Lynch, Morgan Stanley, National Australia Bank, Royal Bank of Scotland and UBS.

CDS series peaks at 6.54% in September 2008.

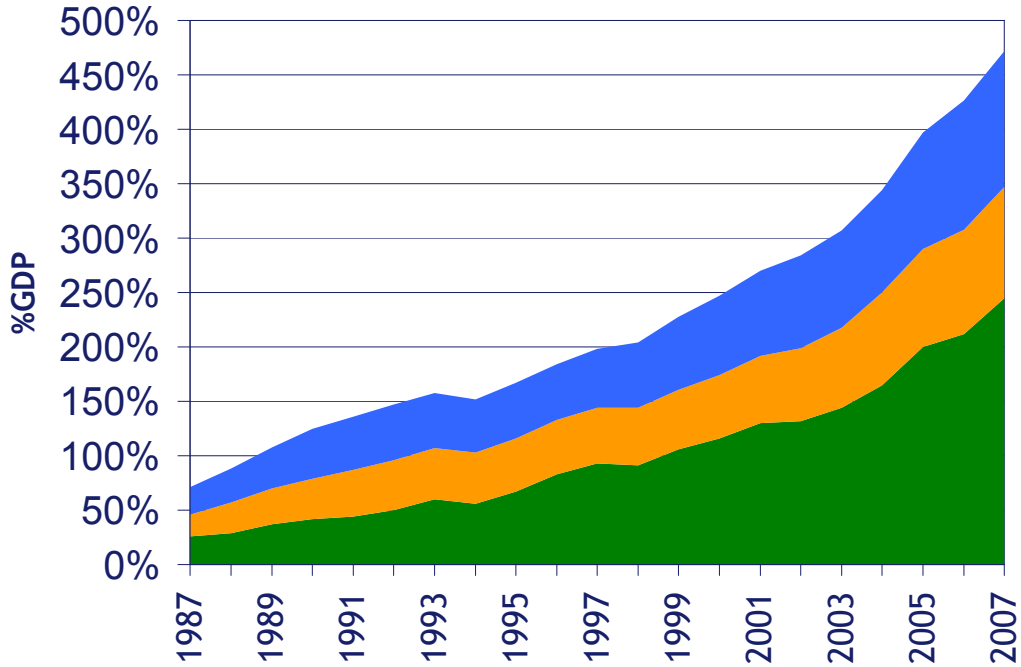
Source: Moody's KMV, FSA calculations

The growth of the financial sector

US debt as a % GDP by borrower type (1987-2007)



UK debt as a % GDP by borrower type (1987-2007)



Financial debt Household debt Corporate debt

Source: Oliver Wyman

Key priorities in banking regulation

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- More and higher quality capital, especially against trading risk
- Gross leverage ratio
- Countercyclical capital buffers – reflected also in published accounts
- Stronger focus on liquidity
- Regulation by economic substance not legal form
- Macro-prudential analysis and tools

- Commercial banks and capital markets trading: a new Glass-Steagall?

- Credit derivatives: operational infrastructure improvements or more fundamental change?

- Cross-border banks as multi-local banks: is deglobalisation a real concern?

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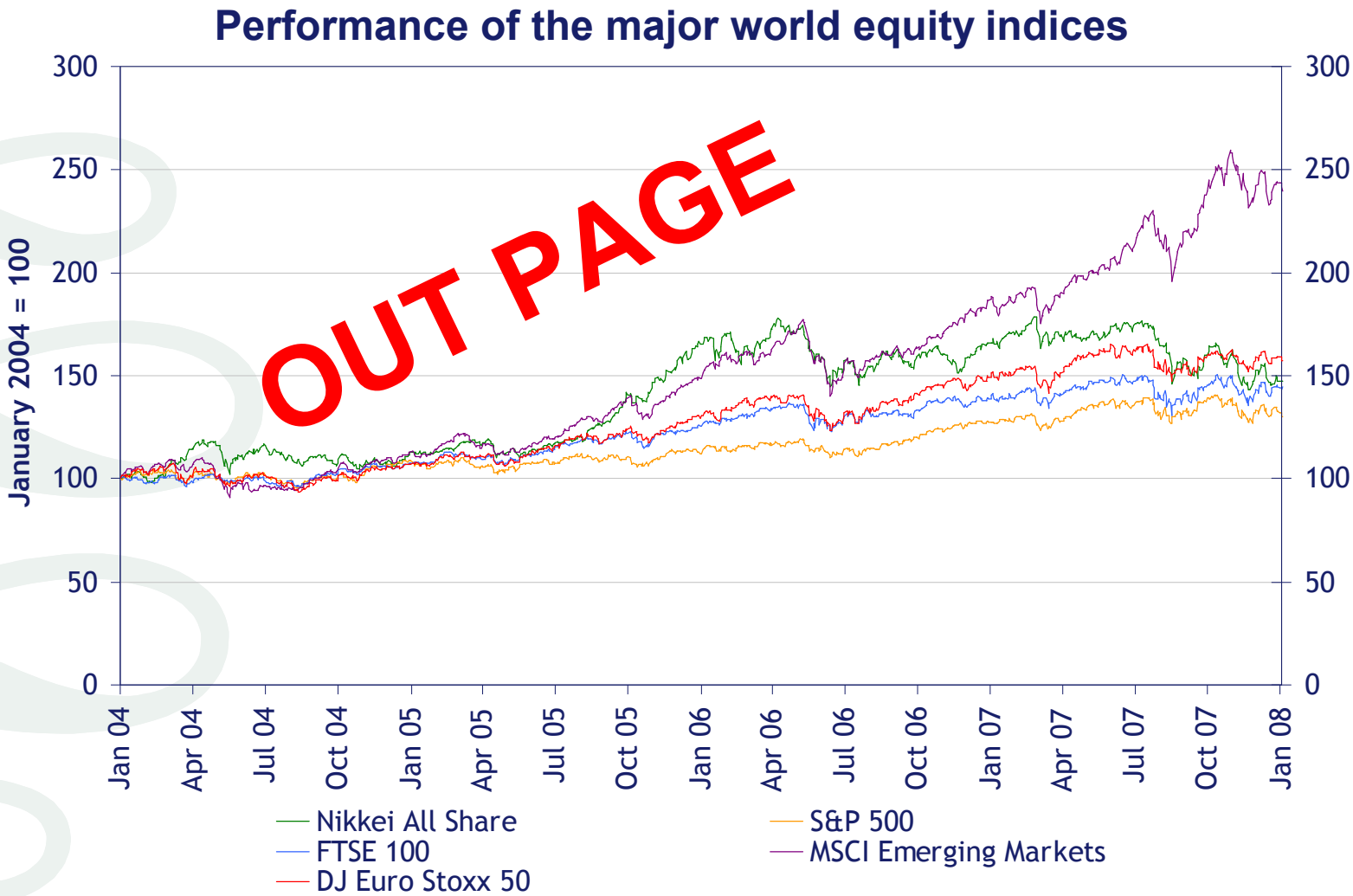
Equity indices



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Source: Thompson Datastream