



30 GROUP OF THIRTY
Consultative Group on International Economic and Monetary Affairs, Inc.

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Founded in 1978, the Group of Thirty is a private, nonprofit, international body composed of senior representatives of the private and public sectors and academia.

Publication of the G30 Report:

The Structure of Financial Supervision: Approaches and Challenges in a Global Marketplace

A report of the G30 Regulatory Systems Working Group
Chairman Paul A. Volcker and Vice Chairman, Roger W. Ferguson, Jr.

Reforms of Banking Regulation Seen as Urgent – Approaches in Many Countries Fall Short in the Face of Today’s Market Strains, the Pace of Financial Innovation and Globalization

New York, October 6, 2008: The Group of Thirty, an international body composed of central bank governors, leading economists, and private financial sector experts, today released a new report providing insights into current challenges facing the global financial system and information to inform future banking regulation reforms. The report, “The Structure of Financial Supervision: Approaches and Challenges in a Global Marketplace,” was issued on the eve of the meeting of G7 finance ministers and central bank governors in Washington, D.C.

“The financial turmoil that has unfolded over the last year has tested the ability of regulatory authorities to respond effectively to financial crises. It is evident that a number of countries need to revise and reform financial regulatory structures,” said Paul Volcker, Chairman of the Group of Thirty’s Board of Trustees.

Mr. Volcker underscored that improvement in regulatory approaches is essential at the national and cross-border levels. The former Chairman of the U.S. Federal Reserve Board, who headed the G30 Regulatory Systems Working Group, said as the impact of the U.S. credit crisis spread to other economies, “We have seen how regulatory approaches and methodologies that may have worked well under benign financial conditions can break down during a major market disruption. We believe that recent events should spur reforms, although we neither underestimate the complexity of the issues that have to be considered, nor the political challenges in overcoming often deeply entrenched traditional approaches.”

The G30 report compares and analyzes the financial regulatory approaches of seventeen jurisdictions, including the United Kingdom, the United States and Australia, in order to illustrate the implications of the four principal models of supervisory oversight: (1) the Institutional Approach, (2) the Functional Approach, (3) the Integrated Approach, and (4) the Twin Peaks Approach (*see descriptions on page 3 of this Press Release*). The U.S. structure, which falls outside of these four approaches, combines institutional and functional approaches with the added complexity of a number of state level agencies and actors.

(Note: The G30 wishes to acknowledge and thank Annette Nazareth, who served as Rapporteur for the Financial and Regulatory Systems Working Group. The G30 also wishes to thank Deloitte & Touche LLP, the Deloitte Center for Banking Solutions, and Zurich Financial Services for their support of the project.)

Roger W. Ferguson, Jr. President and CEO of TIAA-CREF, former Vice Chairman of the U.S. Federal Reserve Board and the Vice Chairman of the G30 Working Group stressed, “As we start to re-examine regulatory structures, the G30 report can play a role by building the fact base that regulators, politicians, and financial market participants will consider.”

Mr. Ferguson added, “The analysis of current practices across 17 jurisdictions reveals the advantages and shortcomings in many systems and provides context for recent events in the global markets. No one model has proven unambiguously superior in achieving all the objectives of regulation. And all policymakers and regulators interviewed emphasized the critical importance of having regulatory frameworks accommodate and keep pace with rapidly-changing financial markets. This is underscored by the restructuring of banking institutions that we are now witnessing.”

Jacob A. Frenkel, Chairman of the Group of Thirty, Vice Chairman of AIG, and former Governor of the Bank of Israel, stated, “The urgency of regulatory reform is that weaknesses and vulnerabilities in the financial system have been exposed that need fixing; battered public confidence in the health of the financial system needs to be addressed in a decisive manner; and actions taken that may better anticipate further possible challenges to the financial sector resulting from today’s prevailing economic conditions.”

Dr. Frenkel stressed that the problems in the financial system are highly contagious today. The fact that recent disruption in the collateralized debt obligation market due to subprime mortgage issues had a wide impact internationally, for example, provides ample illustration of this exposure. He added, “The market turmoil we have witnessed over the last year which has necessitated unprecedented interventions by governments and central banks all over the world to reduce the impact of future disturbances. The G30 report is evidence of the growing recognition that a reassessment of the effectiveness of regulatory approaches is required.”

In March, the U.S. Treasury released its *Blueprint for a Modernized Financial Regulatory Structure*, which proposes a major restructuring of financial supervision toward a regulation by objectives approach, in some ways similar to the twin peaks model to supervision and regulation.¹ The UK has already introduced modifications in its highly integrated approach.

In preparing the report, the G30 conducted interviews with key officials in the relevant jurisdictions, as well as practitioners, regulated parties, and those who may have been involved historically in the development of the current regulatory arrangements.

Key Highlights

Key highlights of the report include

- Strong leadership and high quality people can offset to some degree impediments/deficiencies that stem from non-optimal regulatory structures, but at some point regulatory regimes need to be updated and modernized to accommodate financial evolution, market realities, and global integration.
- Most supervisors stress the importance of an effective, transparent, and efficient deposit protection scheme as a part of today’s financial regulatory architecture.
- A majority of supervisors recognize the value of supervisory “colleges” for systemically important global financial institutions, but most also believe that flexibility in the procedures and operations of these colleges is critical to their success going forward.

¹The Department of the Treasury, *Blueprint for a Modernized Financial Regulatory Structure*, March 2008

- Central banks and supervisors remain concerned that current structures for international coordination may still be tested by the failure of a systemically important international financial institution subject to different national regulatory jurisdictions.

The Four Approaches to Supervision	
The G30 report assesses the four approaches to financial supervision currently employed across the globe (institutional, functional, integrated, and twin peaks). It describes the key design issues of each supervisory model, illustrates how each has been implemented in practice, and assesses the strengths and weaknesses of each approach.	
Institutional	The institutional approach is one in which a firm's legal status (for example, a bank, broker-dealer, or insurance company) determines which regulator is tasked with overseeing its activity from both a safety and soundness and a business conduct perspective. The jurisdictions reviewed that use the institutional approach are China, Hong Kong, and Mexico.
Functional	The functional approach is one in which supervisory oversight is determined by the business that is being transacted by the entity, without regard to its legal status. Each type of business may have its own functional regulator. The countries reviewed that use the Functional Approach are Brazil, France, Italy, and Spain.
Integrated	The integrated approach is one in which a single universal regulator conducts both safety and soundness oversight as well as conduct-of-business regulation for all the sectors of financial services business. The countries reviewed that use this approach are: Canada, Germany, Japan, Qatar, Singapore, Switzerland, and the United Kingdom.
Twin Peaks	The twin peaks approach, a form of regulation by objective, is one in which there is a separation of regulatory functions between two regulators: one that performs the safety and soundness supervision function and the other that focuses on conduct-of-business regulation. The two countries that use the Twin Peaks Approach are Australia and the Netherlands. A number of other jurisdictions are engaged in debates over the adopting this type of approach, including Spain, Italy, and France.
An Exception	The U.S. structure is functional with institutional aspects, with the added complexity of a number of state level agencies and actors. The recent U.S. Treasury Blueprint recognizes the current weaknesses and advocates a modified Twin Peaks Approach as a long-term goal.
NOTE: Key policy goals of financial regulation include: (1) safety and soundness of particular financial institutions; (2) mitigation of systemic risk; (3) fairness and efficiency of markets; and (4) the protection of customers and investors.	

The report noted that recent decades have seen enormous transformation in the financial services sector. There has been a marked shift from domestic firms engaged in distinct banking, securities, and insurance businesses to more integrated financial services conglomerates offering a broad range of financial products across the globe. The traditional demarcations among the products and services offered by banks, insurance companies, and securities firms have substantially blurred, as each has sought to maximize profits through business expansion and financial innovation.

The G30 stated that these developments have exposed the shortcomings of financial regulatory models, some of which have not been updated to reflect new business realities. They also highlight the importance of information sharing and international cooperation by regulators, as financial crises can circle the globe with alarming speed. Ultimately, these developments also point to the need for convergence to high quality, internationally recognized regulatory standards, including international accounting standards, for example. In such an interconnected financial landscape, key protections must be generally accepted and implemented in all major market centers. To do otherwise would risk business migration to less regulated jurisdictions, ultimately posing a threat to the stability of the financial system.

A number of supervisors interviewed by the G30 expressed concern that the international architecture of supervisory coordination and communication has not kept up with the changes in the nature and structure of the global financial marketplace.

Some of the important questions that are now widely being asked and that still need to be addressed by regulators and legislators include: Should unregulated entities, for instance, hedge funds and private equity funds, ultimately be integrated into the regulatory structure? Given their monetary policy, financial stability, and lender of last resort responsibilities, what is the optimal role of central banks in the future regulatory landscape? What are the systemic implications of rescuing failing institutions with important operations in several jurisdictions? Do supervisors have the right mechanisms in place to permit the orderly liquidation of major financial institutions? Are existing mechanisms for cross-border coordination sufficient or do more formal means need to be established?

The report added that the current international coordinating bodies involved in encouraging common standards and the exchanges of information cannot be expected to act as forecasters of emerging financial crises. Moreover, these organizations are generally established along institutional lines (banking, securities, insurance), and as such cannot fully reflect the changing nature of the global financial services marketplace.

Note: Information contained in the G30 report is based on interviews with the relevant authorities in each jurisdiction covered, as well as from other internationally recognized organizations, such as the International Monetary Fund (IMF), the Bank for International Settlements (BIS) and the Financial Stability Forum (FSF).

Media questions about the new report and about the G30 should be addressed to:

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