This Is the Time to Improve Global Standards

BY GREG WILSON

The double whammy of the worst global financial crisis since the 1930s and the worst financial panic since 1907 is the result of clear market failures, regulatory gaps, and supervisory deficiencies nationally and globally.

The Group of 20 Summit on Nov. 15 offers a unique opportunity to start real regulatory reforms globally.

Thanks to daily headlines, the causes of the financial crisis and ensuing panic are clear. Market failures in many countries, not just the United States, include cheap credit, the mispricing of risk, underwriting failures, a breakdown in securitization, and a failure to heed early danger signs.

Regulatory gaps, duplication, and failures are equally striking. The actions needed to correct these deficiencies include common principles to guide regulatory behavior and outcomes, increased accountability and better regulatory coordination in financial services, prudential supervision of all firms, and an early warning surveillance system.

The current U.S. regulatory system, for example, is as complex, cumbersome, and costly as it is ill suited for a modern global financial services world. The United States spends more than $5 billion annually on direct regulatory costs. In sharp contrast, the notional value of the U.S. government's current commitments in the financial crisis are staggering, exceeding $5 trillion.

The question for taxpayers everywhere is "Are we getting our money's worth from the current regulatory regimes, domestically and internationally?"

The pending summit — the first in a series of announced meetings including both developed and emerging markets — is a starting point for improving regulatory standards globally. If they do nothing else, the Group of 20 leaders need to focus on three critical areas.

Early crisis detection. We have warning systems in place today to deal with forces that transcend national boundaries, such as weather and disease, yet most countries lack systems to issue needed alerts for a financial crisis.

Each country needs to establish its own warning capability quickly with clear lines of accountability, responsibility, and reporting. My experience in more than 15 crisis countries shows that clear warning signs are visible well before a financial storm hits, even if the exact timing and velocity are not perfectly predictable.

Globally, the Institute of International Finance has created a Market Monitoring Group to assess the potential for future crises. A newly empowered Financial Stability Forum also is a logical starting place to collect data, analyze information, and issue global alerts as needed.

Regulatory coordination. Better, more formal coordination and cooperation is needed among regulators, as well as between the private and public sectors. It is in everyone's best interest to develop lasting ways to prevent future crises.

At the nation-state level, policymakers, regulators, and financial institutions need to work together to develop common approaches that ensure vibrant financial markets to support economic growth. Joint committees or working groups on specific issues (e.g., underwriting standards and securitization reforms) will also help.

At the international level, efforts are under way and need to be consolidated. Private-sector efforts, such as the IIF's recommendations on market best practices, are a useful starting point.

Mutual recognition of credible regulatory regimes will also facilitate cross-border finance while minimizing duplication and costs.

Clear international standards. Today we have international treaties and agreements on everything from trade and taxes to airline safety and the conduct of war. It is time for the Group of 20 to launch an international accord on financial markets.

A treaty may seem far-fetched, but our financial storm gives us a unique opportunity to agree on truly global reforms.

Participants in the upcoming summit should embrace a few key principles, starting with an acknowledgement that consumers everywhere are best served by competitive financial markets that are effectively regulated and prudentially supervised. When the historic state intervention is unwound globally, a return to market principles with balanced regulation should be another guiding principle.

Subsequent summits should develop this international accord, which should be principles-based. Quick agreement will provide a much-needed compass for the journey ahead. To keep things simple, a treaty should have three major articles. The first article should address universal consumer protections. Customers should be treated fairly, financial literacy should be a priority, and market pricing with full disclosure and fair advertising is a must.

The second article should tackle competition and market conduct. Equal treatment and nondiscrimination across borders, prudential standards for market entry and exit, and requirements for ethical business practices — firm and transparent codes of conduct — are needed.

The third article should promote prudential regulation and efficient supervision. Principles of good corporate government and high standards for risk management and internal controls are essential. Enhanced international supervisory cooperation and coordination are required, especially for the resolution of failing institutions across borders. Creating an international warning system with a mandate to issue public alerts when financial storms appear on the horizon is long overdue.

Our global crisis has spurred actions that were unthinkable a few months ago. We should not let this opportunity to strengthen and improve financial markets pass us by.

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