Global Financial System Report

Stabilizing Global Financial Markets

Sustainable Governance Indicators 2018

SGI Sustainable Governance Indicators

BertelsmannStiftung

Indicator

Stabilizing Global Financial Markets

Question

To what extent does the government actively contribute to the effective regulation and supervision of the international financial architecture?

41 OECD and EU countries are sorted according to their performance on a scale from 10 (best) to 1 (lowest). This scale is tied to four qualitative evaluation levels.

10-9 = The government (pro-)actively promotes the regulation and supervision of financial markets. It demonstrates initiative and responsibility in such endeavors and often acts as an international agenda-setter.

8-6 = The government contributes to improving the regulation and supervision of financial markets. In some cases, it demonstrates initiative and responsibility in such endeavors.

5-3 = The government rarely contributes to improving the regulation and supervision of financial markets. It seldom demonstrates initiative or responsibility in such endeavors.

2-1 = The government does not contribute to improving the regulation and supervision of financial markets.

Canada

Score 9

The Canadian government, through various departments and agencies, contributes actively to the effective regulation and supervision of the international financial architecture. The Bank of Canada has been particularly prominent in the international arena. Former Bank of Canada Governor Mark Carney, who assumed the position of Governor of the Bank of England in 2013, chairs the G-20 Financial Stability Board. Other senior Bank of Canada officials have played important roles in other international financial forums. The Office of the Superintendent of Financial Institutions (OSFI) has also been very active internationally.

Finland

Score 9

Following the collapse of financial markets in Europe and the increased vulnerability of financial markets globally, political leaders in Finland have urged the passage of stronger regulations and more coordinated market supervision. In terms of attitudes and action, Finland has presented itself as an agenda-setter, providing support to countries seeking to advance self-regulation and combat excessive market risk-taking. Finland has also pursued measures to secure its own finances. According to an assessment by the International Monetary Fund in December 2016 of the stability of the Finnish financial system, Finland's banking system has remained well-capitalized and profitable, a three year recession notwithstanding. Also, while low interest rates have squeezed net interest income, banks have increased income from trading and insurance. Importantly, Denmark, Finland, Norway and Sweden all have sound financial systems that have withstood the impact of the European financial crisis. In 2013, the Finnish government approved the Europe 2020 National Program, which contains measures and national targets for achieving the goals of the Europe 2020 strategy. The program includes proposals to create an effective national macroprudential supervision system. With some 200 employees, the Financial Supervisory Authority is tasked with overseeing Finland’s financial and insurance sector. The Financial Markets Department of the Ministry of Finance creates the rules for financial markets and the framework in which markets may operate; the department is also responsible for ensuring that the Ministry of Finance’s international activities remain effective.

Citation:
“Finanssimarkkinoiden makrotaloudellisten vaikutusten sääntely ja valvonta”, Työryhmän muistio 32/2012, Ministry of Finance, Publications 2012;
imf./org/en/Publications/CR/issues/2016/12/31/Finland-Financial-System-Assessment-44437;
www.Springer.com/cda/content…/978146/14955352-c1.pdf?

Germany

Score 9

In the aftermath of the financial crisis, policy initiatives in the field of financial market governance underwent a strategic realignment from private self-regulation toward public regulation, with the aim of in the future avoiding costly public bailouts of private banks. Germany has assumed a leading role in the fight against the sovereign debt crisis in Europe, and has accepted substantial explicit and implicit liabilities. For example, Germany’s maximum financial guarantee for the European Stability Mechanism amounts to €190 billion and the country is also exposed to indirect risks through the Bundesbank’s claims in the European Central Bank’s TARGET payment system which, as a consequence of the European Central Bank asset purchases, are increasing.

Germany has been an early advocate of a European banking union, integrating several elements into national law (e.g., rules for bank restructuring in a crisis) before EU standards emerged. Internationally, Germany argued vigorously in favor of coordinated, international steps to reform the global financial system, and to eliminate tax and regulatory havens. In addition, Germany is one of the driving forces that helped to develop the G-20 summit into a first-class forum for international cooperation. Despite these efforts, however, Germany has also clearly defended the interests of its domestic banking system, particularly with respect to the special deposit insurance programs of state-owned savings banks (Sparkassen). The government remains concerned that pooling Europe’s deposit insurance systems too early could result in the European collectivization of bad bank debts.

Although skeptical at first, the German government ultimately revised its position regarding the implementation of an EU level financial transaction tax (FTT). The European Commission proposed to introduce an FTT within the European Union by

2014. In December 2017, a Progress Report underlined that only limited progress has been made (European Parliament 2017). While there has been limited progress, Germany and France remain the strongest proponents of an EU FTT. Now that its strongest opponent, the United Kingdom, is leaving the European Union, a FTT seems more likely to be established for the remaining ten participants. The issue is currently at a standstill in the European Council. In June 2017, the ECOFIN reiterated that further work at the European Council and its preparatory bodies is still required.

Citation:
European Parliament (2017): http://www.europarl.europa.eu/legislative-train/theme-deeper-and-fairer-internal-market-with-a-strengthened-industrial-base-taxation/file-financial-transaction-tax

Sweden

Score 9

The Swedish government has stood behind essentially all efforts to enforce regulation aiming at preventing criminal financial behavior in international financial management. Sweden also supports and implements rules laid out by the European Union and other international institutions related to international finance. It has rejected proposals, however, to introduce a Tobin-style tax on international financial transactions.

On the domestic scene, some friction between the finance ministry and the big commercial banks has been noticeable over the past couple of years. The discord has related to the banks' insistence on giving their staff huge bonuses and charging high financial management fees. Another potential source of friction between the finance ministry and the major commercial banks is related to political signals to force lenders to mortgage their loans and not just pay interest. The Ministry, in concert with the National Bank, is concerned about the level of household debt, suggesting that there is a growing bubble in the metropolitan real-estate markets. Reducing debt and/or phasing out the right to deduct interest payments would help reduce the likelihood of such a bubble. Although the banks do not have a commercial interest in debt reduction, they too have recently stated concerns with the high household debt levels.

Taken together, Sweden is a forerunner for the sustainable regulation of international as well as domestic financial markets. This status is a consequence of the financial crisis in Sweden in the early 1990s, which initiated rapid policy learning in all major parties represented in the Swedish parliament.

Belgium

Score 8

Belgian banks suffered extensively during the global financial and economic crisis, and the Belgian government was more proactive than many of its European peers in restructuring banks. Yet Belgium is clearly too small to be able to restore financial stability alone. Indeed, some of the largest Belgian banks are structurally linked to other European banks, or have in fact become subsidiaries of larger banks with headquarters based in neighboring countries (e.g., ING, BNP Paribas). This has led the government to promote international efforts to restore financial stability and combat financial fraud and tax evasion (from which Belgium is a clear loser, in spite of repeated initiatives to recover revenues lost through tax evasion using banks based in countries such as Luxembourg). Belgium also took an active part in the creation of the so-called banking union in the euro area, and has sought to improve banking supervision within its borders. Various scandals such as the Panama and Paradise papers press leaks have also given new impetus to the government's efforts to improve banking transparency. Indeed, some Belgian investigative journalists were instrumental in these projects, working alongside peers from other countries.

Citation:
http://plus.lesoir.be/118686/article/2017-10-11/panama-papers-les-socialistes-maintiennent-la-pression
http://plus.lesoir.be/123189/article/2017-11-08/paradise-papers-meme-letat-belge-senvole-aux-iles-vierges#123186

Denmark

Score 8

In the wake of the global financial crisis, various banking "packages" were implemented. In the first stage, the aim was to support the liquidity and functioning of the system, and in the later stage, to ensure a smooth adjustment in the financial sector. The overall policy was guided by a principle that the state must regulate the sector, but the sector itself must cover the costs. A number of small and medium sized banks have been merged (and a few closed) as a result, but with no fiscal implications (i.e., the main principle was bail-in mechanisms).

Regulation of the financial sector is being changed in accordance with EU-rules and regulations. Financial institutions of systemic importance are subject to specific requirements. The financial supervisory authority plays an important role and has been increasingly proactive. A systemic risk council monitors and surveys developments in the financial sector.

An open question is whether Denmark should participate in the European banking union. The governor of the Danish central bank, Lars Rohde, has on various occasions spoken out in favor of Danish participation in the banking union. Jörg Asmussen, a member of the Executive Board of the European Central Bank, has advised Denmark to join. In April 2015, while in opposition, Lars Løkke Rasmussen (the current prime minister) said that it would be in Denmark's interest to join the banking union, but that he saw no urgency. There hasn't been much debate in Denmark since 2015 about joining the banking union, but the current three-party government has initiated a committee to assess the advantages and disadvantages of joining the banking union. Minister of Business Brian Mikkelsen seems in favor, arguing that it will attract investment, but the government's parliamentary support party, the Danish People's Party, remains skeptical.

Citation:
Danmarks Nationalbank, "Economic-policy cooperation in the EU," http://www.nationalbanken.dk/DNUK/Euro.nsf/side/Economic-policy_cooperation_in_the_EU!OpenDocument (accessed 2 May 2013).

Kraka Finanskrisekommission, 2014, Den danske finanskrise - kan det ske igen?; København.

Rangvid, J. m.fl. 2013, Den finansielle krise i Danmark - årsager, konsekvenser og læring, report from government appointed commission.
"Nationalbankdirektør Lars Rohdes tale ved realkreditrådets årsmøde 2. October 2014," http://www.nationalbanken.dk/da/presse/Documents/2014/10/LRO%20tale%20RKR%20021014.pdf (accessed 17 October 2014).

Jörg Asmussen, "Banking Union -essential for the ins, desirable for the outs!" http://www.ecb.europa.eu/press/key/date/2013/html/sp131105.en.html (accessed 17 October 2014).

"Løkke om bankunion: Vi skal skynde os langsomt." http://www.dr.dk/nyheder/politik/loekke-om-bankunion-vi-skal-skynde-os-langsomt

"Pyha, Bankunionen er sparket til hjørne," http://www.business.dk/finans/pyha-bankunionen-er-sparket-til-hjoerne (Accessed 23 October 2016).

"Regeringen genovervejer EU's bankunion," http://www.altinget.dk/artikel/regeringen-genovervejer-eus-bankunion (Accessed 5 November 2017).

Estonia

Score 8

Estonia actively participates in developing and securing financial stability and transparency in global financial markets. Two measures are particularly notable. First, the government has taken action in the prevention of money laundering. Estonia has signed major international agreements and is a member of the Moneyval. It has also established several domestic bodies to combat money laundering, such as the Governmental Committee for the Coordination of Money Laundering Prevention, the Financial Intelligence Unit and others. The Estonian Financial Intelligence Unit (FIU) is an independent unit of the Estonian Police and Border Guard Board. The FIU analyses and verifies information in case where money laundering or terrorist financing are suspected, taking measures where necessary and forwarding materials to the competent authorities upon detection of a criminal offence. The Anti-Money Laundering and Terrorist Financing Prevention Act was amended in 2017, extending to all companies the obligation to declare the effective beneficiaries of financial transactions.

Estonia has also been actively involved in euro zone bailouts, but the government plays only a limited role in addressing international financial-market failures, due both to the fact that most banks are foreign-owned, and to its own neoliberal policy outlook.

France

Score 8

French governments of either political complexion are generally in favor of regulation and control of the global financial system. The Hollande government, like its predecessor, has been active internationally and at the EU level in supporting better international banking regulations. Both administrations have been strongly supportive of all initiatives contributing to the re-capitalization of banks, to the better control of speculative funds and to the fight against fiscal evasion and tax havens. They also have been active, together with 10 other EU member governments, in proposing to impose a levy on financial transactions (the so-called Tobin tax). In spite of the standstill situation over introducing this tax, the new government has declared its support for this initiative. Recent French governments have also pushed for the creation of a banking supervision mechanism at the EU level. The Hollande and Macron governments have been or are committed to improving fiscal cooperation on information exchange, the fight against tax havens and tax evasion. In 2016, the French parliament adopted a better system of controls and sanctions against corruption at the international level (“Loi Sapin 2”).

Israel

Score 8

During Israel’s process of OECD accession its financial regulation was assessed against a number of suitability criteria. Related reports note that Israel signed the convention on combating bribery and successfully passed the three-stages review required by the convention. It also took steps to impose criminal penalties and apply the law to transactions made by Israeli companies abroad. In accordance with OECD standards, Israel also established an authority tasked with increasing the accessibility of financial information. The authority works with corporate experts and publishes materials in Hebrew, Arabic and English. It also operates a public inquiries office for public complaints.

Israel has several regulatory institutions tasked with supervising financial markets. The most prominent include the Israel Securities Authority (ISA) and the Israel Antitrust Authority (IAA). These institutions are responsible for insuring market stability and fair competition. In the aftermath of the global financial crisis, different government organizations worked to limit the risk in the banking and insurance industry. Actions include tightening the rules on mortgages, adopting Basel III regulation and raising minimum capital ratios. Several committees have been formed to investigate structural reforms and submitted their recommendations. Both OECD and central bank assessments have been cautiously optimistic, with the latter pointing to important regulatory tools that are currently being developed for future implementation.

In 2016, following OECD recommendations, the government approved the creation of a new capital authority. The Department of Capital in the Finance Ministry has been shuttered, and a new, independent authority put in its place, although the Finance Minister still oversees this body. Among its fields of responsibility, the new authority is in charge of ensuring the stability of regulated finance institutions and making sure they fulfill their obligations to their customers.

Citation:
"Financial stability report," Bank of Israel 2014 (Hebrew). "Israel – Economic forecast summary," November 2014. http://www.oecd.org/economy/israel-economic-forecast-summary.htm.
Sasson, Asa, "The government approved the creation of the new finance authority," The Marker 13.03.2016. http://www.themarker.com/markets/1.2881163

Lithuania

Score 8

Lithuanian authorities contribute to improving financial-market regulation and supervision. Lithuania joined the euro zone and the single European banking supervisory system in 2015. The Lithuanian Ministry of Finance and the Bank of Lithuania (the country's central bank) are involved in the activities of EU institutions and arrangements dealing with international financial markets (including the European Council, the European Commission, the European Systemic Risk Board's (ESRB) Advisory Technical Committee, the European supervisory authorities, etc.). Lithuanian authorities are involved in the activities of more than 150 committees, working groups and task forces set up by the European Council, the European Commission, the ESRB's Advisory Technical Committee and other European supervisory authorities.

In addition, the Bank of Lithuania cooperates with various international financial institutions and foreign central banks, in part by providing technical assistance to central banks located in the European Union's eastern neighbors. Lithuania's Financial Crime Investigation Service cooperates with EU institutions, international organizations and other governments on the issue of money laundering. The country has lent its support to many initiatives concerning the effective regulation and supervision of financial markets. In recent years, the Bank of Lithuania has tightened regulation of short-term lending practices to target so called fast-credit companies and attract foreign financial institutions. At the same time, the Bank of Lithuania has attempted to attract fintech companies to Lithuania, in the context of the United Kingdom leaving the European Union, to increase competition in the banking sector.

Norway

Score 8

Being a small country, Norway is not a major actor in international financial regulation. However, it is a notable player in financial markets as a result of its sovereign wealth fund. In this area, it has set standards of good international financial governance. The fund itself has been a conservative voice in international financial discussions, and leads by demonstrating good practices. The set of so-called Santiago principles have established procedures for increasing transparency related to sovereign wealth funds, which has undoubtedly constrained government action in similar areas. Norway is supportive of international efforts to combat corruption, tax evasion and the like. Although the financial sector is heavily exposed to the petroleum and shipping sectors, both of which have had to navigate difficult economic times, the financial sector remains robust and stable, which is in part a result of the regulatory reforms introduced by the government. In 2016, the fund also supported the G20-based initiative of carbon risk financial disclosure and joined a working group to explore how sovereign wealth funds can contribute to the achievement of Paris Agreement targets.

Switzerland

Score 8

Switzerland is one of the world's most significant financial markets. Swiss banks such as UBS and Credit Suisse are global financial players. The post-2007 global crisis and the economic problems of UBS in Switzerland – which forced the Swiss government to intervene massively in order to avoid bankruptcy of this major bank in 2008 – triggered banking reforms within Switzerland. The federal government, bankers and international organizations such as the OECD claim that Swiss private and public actors have been active on the global level in reforming the international banking system, in particular in interaction with the regulatory bodies in the United Kingdom, the United States and the European Union.

After the financial crisis of 2007 and 2008, the government introduced measures to deal with the problem of banks being "too big to fail." Though it remains unclear whether these new rules and institutions will be sufficient in the event of a major crisis, the Swiss approach numbers among the most sound and prudent systems of regulation worldwide.

Australia

Score 7

As a globally oriented country with a high degree of international economic integration, including financial market integration, Australia has a strong interest in promoting a stable, efficient and transparent international financial system. Australia displays a strong commitment to preventing criminal financial activities, including tax evasion. To that end, the government has information sharing arrangements with a number of countries. However, Australia is a relatively small player in international finance and has a limited ability to shape the regulatory process within multilateral institutions.

After the financial crisis of 1989 to 1990, Australia successfully improved its national financial regulations. Prudential supervision of Australian banks and other financial institutions is now of high quality. Indeed, reflecting its strong regulations, no Australian bank experienced substantial financial difficulties throughout the financial crises that began in 2008. In 2014, the Abbott government commissioned a broad-ranging inquiry into the Australian financial system, focusing on how the financial system can most effectively help the Australian economy be productive, grow and meet the financial needs of Australians. The report made 44 recommendations, a number of which have been implemented by the Turnbull government. Measures have included an increase in banks' capital-adequacy requirements. According to government estimates, the four big banks needed an additional AUD 40 billion in fresh capital. Additionally, the 2017 budget introduced a "major bank levy" on banks with over AUD100 billion in total liabilities, applying to the five largest banks. The levy rate is set at 0.015% of the balance of a bank's total liabilities (but with a number of exclusions), and is expected to raise around AUD1.5 to AUD1.6 billion per annum.

While Australian banks appear to be stable, their capital base is weak, the reason being their enormous exposure to real estate lending. For a real estate loan of AUD 500,000 dollars, a bank only has to hold AUD 10,000 of capital. Given the high price levels for real estate in Australia, that cushion appears inadequate.

Australia has also accumulated a high level of net foreign debt, currently totaling AUD 1.06 billion. While this high level of debt is a risk to Australia's financial stability, Australian governments have not addressed this issue, arguing that it reflects the decisions of the private sector (including households). In 2017, household debt was 122% of GDP, the second-highest in the OECD after the Netherlands.

Australia's gross debt – at AUD 1.90 billion – is almost twice the net debt level. While the Australian government has favored the use of net rather than gross figures, a realistic perspective needs to consider the latter. The simple reason is that those that hold claims on the rest of the world may not be identical to those that have borrowed from the rest of the world. In other words: Those that need to repay the debt might be, or most probably are, different from those who receive dividends and interest from investments abroad. In the event of a crisis, gross debt is the figure that matters.

Citation:
Buttiglione, Luigi; Lane, Philip R.; Reichlin, Lucrezia and Vincent Reinhart (2014): Deleveraging? What

Deleveraging? Center for Economic Policy Research, Geneva Reports on the World Economy, Nr. 16 (September 2014), p. 15.

Financial System Inquiry Final Report, December 2014: http://fsi.gov.au/publications/final-report/

Is it time to end ultra-low rate regime?, The Australian, 11./12. March 2017, p. 25.
https://tradingeconomics.com/australia/external-debt

The Economist, Like a shag on a rock, 16.5.2015, S. 63.

https://data.oecd.org/hha/household-debt.htm#indicator-chart

Austria

Score 7

As a member of the European Union, Austria's economy is closely linked to the other members of the European Single Market. Austria has nevertheless sought to defend special national interests against the implementation of general standards such as banking transparency. Therefore, Austria has come under pressure from the United States and fellow European Union members to open its financial system according to standards widely acknowledged and respected by most other financial actors worldwide. This led to the decision to essentially abolish banking secrecy, for which Austria was long known.

Austria has been particularly engaged in the promotion and implementation of an EU-wide tax on financial transactions. In January 2013, 11 European countries agreed to introduce a financial transaction tax, but the implementation of the tax remains uncertain. Concerning a policy of reducing the impact of "tax havens" within the European Union (e.g., Malta, Cyprus and several self-governing British dependency islands), the Austrian attitude has been more or less within the mainstream –principally in favor, but not enthusiastic in leading any reform. This can be explained by the fact that, although Austria is not a tax haven itself, Austrians (individuals, corporations) are among those who profit from existing tax havens.

Italy

Score 7

The government and other public financial institutions such as the Bank of Italy have been generally supportive of international and European policies oriented to improve the regulation and supervision of financial markets. Typically for Italy, the government and the Bank of Italy have preferred a collective working style within the framework of EU and G7 institutions rather than embarking on uncoordinated, but highly visible initiatives. However, the government has occasionally failed to fully understand the implications for the economy and banking sector of the introduction of new international regulations. It has therefore not been fully prepared for the consequences of the new rules.

Latvia

Score 7

The volume of bank deposits made by non-residents has presented a systemic risk to the Latvian financial system. However, this risk is declining. The share of non-resident deposits to total deposits shrank from 53.4% in 2015 to 42.8% in 2016. The share of non-resident deposits continued to fall in 2017 as Latvia's membership in the OECD and new international banking regulations saw Latvia's regulators and banks tighten their anti-money laundering practices. Latvia was lauded for this in an annual report from the OECD.

Latvia's banking system is increasingly interconnected with the Nordic and Baltic regional system, requiring increased collaboration to address Nordic parent bank vulnerabilities and their spillover effects.

Citation:
1. IMF (2017), Article IV Consultation Report, Available at: https://www.imf.org/en/Publications/CR/Issues/2016/12/31/Republic-of-Latvia-2016-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-43983 Last Assessed: 19.11.2017

Malta

Score 7

Malta is a small economy and as such is not a principal actor in the regulation of financial markets. However, it possesses consolidated links with regional and international organizations which help it, through shared intelligence, to combat high-risk or criminal financial activities, ensuring fair cost- and risk-sharing among market actors when a market failure occurs or is likely to occur, and to enhance information transparency in international markets and financial movements. The Central Bank of Malta, Malta Financial Services Authority (MFSA) and Ministry of Finance collaborate closely with similar bodies abroad. Moreover, the Central Bank of Malta operates within the European System of Central Banks. Supranational regulatory regimes highly influence Maltese banking regulations. For instance, the 2014 European Bank Recovery and Resolution Directive was transposed into Maltese law in 2015. In the same year, the Central Bank of Malta introduced the concept of a Central Credit Register, which is "a database which contains non-anonymous information, debtor exposure-by-exposure, of both legal and natural persons, provided by resident credit institutions (banks) licensed by the MFSA" and requires Maltese banks to report end-of-month balances of exposures exceeding €5,000.

The government established the Financial Intelligence Analysis Unit (FIAU), under the Prevention of Money Laundering Act, to help combat high risk or criminal financial activities. The FIAU is responsible for the collection, collation, processing, analysis and dissemination of information with a view to combating money laundering and the funding of terrorism. The unit is also responsible for monitoring compliance with the relevant legislative provisions as well as issuing guidelines to curb money laundering. Although the FIAU forms part of the Ministry for Finance, the unit functions autonomously and has a separate judicial personality. Throughout its years of operation, the FIAU has signed 14 MoUs with other FIAUs and is currently spearheading the transposition of the EU's Fourth Anti-Money Laundering Directive to Maltese law, including new legislation setting up a registry of companies' beneficial owners.

In 2017, the MFSA engaged Promontory, an international regulatory consultancy firm, to carry out an overview of the MFSA. The report makes a number of recommendations on the MFSA's supervisory resources which are now being implemented by the authority's management. The authority is constantly recruiting and training staff on the various areas which fall under its responsibility. Malta is also a member of MONEYVAL, a European committee of experts evaluating anti-money laundering measures. In its last report (2015), Malta had reached a satisfactory level of compliance comparable to a LC rating. The MFSA recently organized trainings in relation to the MONEYVAL assessment. Recommendations have also been made for tightening oversight of the regulator. However, the Economic Crimes Unit and National Counterfeit Unit within the Maltese Police Force remain relatively weak and the number of convictions and sanctions for money laundering have been low.

Citation:
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The Malta Independent 16/04/2015 Central Credit Register to become operational by October
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https://www.financemalta.org/publications/articles-interviews/articles-and-interviews-detail/prevention-of-money-laundering-and-funding-of-terrorism-regulations-2017/
http://www.fiumalta.org/library/PDF/misc/Bill_ENG.pdf
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Financial Intelligence Analysis Unit Annual Report 2015
The 4th Anti-Money Laundering Directive, An Academic Analysis. A Policy paper by ELSA Malta's Social Policy Organizing Committee
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http://www.imf.org/en/News/Articles/2017/11/17/ms111717-malta-staff-concluding-statement-of-the-2017-article-iv-mission
MFSA Annual Report 2016

Netherlands

Score 7

The Intervention Bill, which came into effect in June 2012, includes new powers for the Netherlands' central bank and minister of finance. The bill grants the former the power to oversee the transferal of a bank or life-insurance company experiencing serious financial difficulty to a third party and it grants the latter the authority to intervene in the affairs of financial institutions in order to maintain systemic stability.

As a result, the capital ratio of the four largest Dutch banks has gradually moved toward compliance with the new European capitalization requirements.

Following a parliamentary inquiry into the country's handling of the banking crisis, the Center for Economic Policy Analysis now annually produces a risk report on financial markets. In 2017, although the government considers increased policy uncertainties in the international political environment a threat, it also observes that it does not (yet) affect the stability of (Dutch) financial markets.

The Netherlands is slowly but surely losing its position in the important bodies that together shape the global financial architecture. In the European Union, the Netherlands is skeptical about stronger financial governance authority in the sphere of financial support (emergency fund) and bank oversight. On the other hand, as a small but internationally significant export economy, the Dutch have a substantial interest in a sound international financial architecture. However, given the new wave of political skepticism toward international affairs, as exemplified by a no-vote in the 2016 Ukraine referendum, the Dutch should be regarded more as reluctant followers than as proactive initiators or agenda setters. Recent statements by Prime Minister Rutte regarding Macron's plans for the EU project have confirmed this. In addition, the government has been hesitating to deal with gross inequalities in the fiscal treatment of foreign and domestic capital. This may indicate a return to a financial policy agenda driven more by national interests than by broader concern with global financial safety. After all, Amsterdam is joining the race for luring international financial organizations from London to the European continent.

Citation:
CPB Risicorapportage Financiële Markten 2017. Uitgevoerd op verzoek van de Tweede Kamer. CPB Notitie 6 June 2017

Nederlands Instituut voor Internationale Betrekkingen Clingendael, Conferentie "Veranderingen in het multilaterale bestel voor international economisch en financieel beleid. Uitdagingen voor Nederland en Belgie," 22 oktober 2012, Den Haag.

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Slovakia

Score 7

As a small country, Slovakia has very limited capacity to influence the regulation or supervision of the global financial markets. Regarding these issues, it tends to follow the EU mainstream. Slovakia has been supporting the international regulation of financial markets, including the creation of a banking union and implementing all European Union directives regarding supervision of financial markets as well as the establishment of the European Fund for Strategic Investments. Slovakia supports also the transparency of tax systems in order to enhance investment activities and the monitoring of cross-border financial flows both within Europe and globally.

Spain

Score 7

Though aware of its limitations as only a medium-sized power and indebted economy, Spain behaves as an important partner in international forums and tries to contribute actively to improving the regulation and supervision of financial markets. This participation has been given weight by its role as one of the countries hit particularly hard by the global economic crisis and the financial instability. It participates in the G-20 meetings as a "permanent guest," and sits on the Financial Stability Board. It is also part of the IMF system (with 1.94% of the votes) and the World Bank (1.74%). It has also been engaged within the OECD in the fight against tax havens, with a particular focus on Andorra and Gibraltar. In 2017, Luis de Guindos was appointed new governor of the Asian Infrastructure Investment Bank, representing Spain. At the European regional level, Spain is a member of the EU and is the fourth most important state within the euro zone. It has pushed hard in recent years for a banking union and for the European Central Bank to take a more active role in strengthening the single European currency. It has also sought to strengthen regulation of rating agencies.

Citation:
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https://elpais.com/elpais/20 17/05/15/inenglish/1494834628_86417 1.html

Turkey

Score 7

Turkey has actively contributed to the work of the Group of Twenty (G-20), the international forum comprising the world's 20 leading industrialized and emerging economies. One of Turkey's key priorities for its presidency of the G-20 in 2015 had been to promote inclusive economic growth globally. During Turkey's presidency, the G-20 agreed to reduce youth unemployment by 15% by 2025, adopted a set of policy recommendations to reduce inequality and established Women-20 (W20) as a stand-alone engagement group to promote gender-inclusive economic growth. In addition, the G-20 adopted a framework at the G-20 leaders' summit in Antalya to strengthen dialogue between the G-20 and low-income developing countries. Turkey's G-20 presidency also brought global peace and security issues to the agenda, as these issues are closely related to sustainable and inclusive economic growth.

Citation:
G20 country report, Turkey 2017, http://www.bundesfinanzministerium.de/Content/DE/Downloads/G20-Dokumente/Hamburg _Wachstumsstrategien/TUR-Growth-Strategy.pdf?__blob=publicationFile&v=3

United Kingdom

Score 7

The City of London is home to one of the world's main financial hubs. Consequently, governments in the United Kingdom have traditionally tried to protect the interests of the City of London against more intrusive regulation whether national, European or global. Governments have often argued that the special characteristics of London as a financial center are not given sufficient attention by Brussels in particular. The Libor scandal of 2012 over the fixing of market interest rates, as well as other instances of market abuse, contributed to a reduction in public support for the financial sector and increased public pressure for tighter financial regulation.

At the international level, successive governments have taken a prominent role in attempts to improve the international regulatory framework through international bodies, such as the Financial Stability Board (chaired by the governor of the Bank of England) and the Bank for International Settlements, as well as through the prominent role of the Bank Governor in the European Systemic Risk Board. The United Kingdom has had substantial influence on EU financial reforms, both through government action and in the form of initiatives from the City of London.
Continued uncertainty about future relations between the United Kingdom and the European Union could affect the United Kingdom's stance on global financial regulation, but the expectation is that UK financial regulation will remain closely aligned with EU and international standards.

The European Banking Agency will move from London to Paris.

United States

Score 7

Prior to the Trump presidency, the United States had generally promoted prudent financial services regulation at the international level. This includes participation in international reform efforts at the G-20, in the Financial Stability Board (FSB), and in the Basel Committee on Banking Supervision (BCSC). U.S. negotiators played a major role in developing the Basel III capital rules adopted in June 2011, as well as the liquidity rules adopted in January 2013. The global nature of the recent financial crisis necessitated a multilateral approach and the promotion of a robust financial-policy architecture. The Obama administration took the initiative in transforming the G-20 into a new enlarged "steering group" for global financial policy. This reconfiguration could not have become reality without strong U.S. engagement. Indeed, the U.S. encountered significant resistance in international forums regarding its efforts to establish effective financial regulation.

With respect to the national regulatory framework, U.S. regulatory bodies had been developing rules required by the 2010 Dodd-Frank Act. U.S. regulators generally preferred stronger rules than international standards required (e.g., on the regulation of derivatives). However, lobbying by the powerful financial services industry had weakened U.S. standards.

Significantly, the Trump administration has promised to repeal the Dodd-Frank Act or at least to significantly relax the implementing regulations. More critically, the U.S. has ceased any support for the development of enhanced international standards by the G-20 sponsored Financial Stability Board (FSB). It may effectively veto any such development; thus, the FSB effort is likely defunct.

Citation:
https://www.wsj.com/articles/curtains-for-global-financial-regulation-1492037557

Chile

Score 6

Given its small size, Chile has quite limited power within international arrangements and, although it participates in regional institutions and regimes, the country has distanced itself from the recent tendencies of its Latin American neighbors to strengthen their respective independence from international-level political hegemony and financial sources. During the world economic and financial crisis, the government applied an austerity policy and engaged in a responsible budgeting policy mandating a 1% structural surplus, largely shielding itself from crisis effects. Nevertheless, in the national as well as international context, the official political discourse privileges the virtue of a totally deregulated and free market, combating any forms of state regulation.

Ireland

Score 6

Ireland’s situation as a member of the euro zone and of the European banking system needs to be taken into account. This has involved substantial surrender of national sovereignty and autonomy in financial policy to the European Central Bank (ECB).

Ireland received only marginal relief on the debt burden it incurred to avert a European-wide banking crisis in 2008. However, in September 2014, euro zone finance ministers agreed to allow Ireland to refinance its debt based on its dramatically improved credit rating. This enabled it to use funds raised on the international bond market at interest rates near 2% to retire IMF debt carrying interest rates of close to 5%.

From evidence presented at the public hearings of the Oireachtas Banking Inquiry in 2015 and published in the Committee of Inquiry into the Banking Crisis’s Banking

Inquiry Report 2016, it is clear that the ECB pressured Irish authorities not to "bail in" the bondholders of Irish banks that had failed. The motivation for this was to avert impairment of the balance sheets of German and French banks, which were significant investors in these Irish banks. It is contended in the report that the ECB exceeded its authority in pressuring one country to bear the cost of shielding banks in other euro zone countries from the consequences of their imprudent investment decisions. Jean Claude Trichet, the then president of the ECB, refused to give direct evidence to the Inquiry on the grounds that the ECB is accountable to the European Parliament and not to national parliaments. He did, however, take questions from members of the Inquiry and defended his 2008 actions at a public lecture he delivered in Dublin in April 2015.

Citation:
Committee of Inquiry into the Banking Crisis (Banking Inquiry Report), January 2016.
Donal Donovan and Antoin E. Murphy The Fall of the Celtic Tiger Ireland and the Euro Debt Crisis (Oxford University Press, 2013; paperback 2014)
A posthumous biography of or tribute to the man who was Minister for Finance in 2008 sheds light on the interaction between Ireland the European institutions during the banking crisis:
Brian Lenihan in Calm and Crisis edited by Brian Murphy, Mary O'Rourke and Noel Whelan, Irish Academic Press 2014

Japan

Score 6

As host of the 2016 G-7 meeting, Japan had an agenda-setting opportunity. However, reforming the global financial architecture has not been a high-priority issue for Japan. Rather, the prime minister used the meeting to push his domestic political agenda by drawing an alarmist picture of the global economy, in attempts to legitimize the decision announced a few days later to postpone the increase of the consumption tax.

On the regional and plurilateral level, Japan's influence has been somewhat eclipsed by China, as China is heavily involved in creating a number of new international financial institutions such as the (BRICS) New Development Bank and the BRICS Reserve Contingency Arrangement. With respect to the Asian Infrastructure Investment Bank (AIIB) initiated by China, Japan initially elected not to join. In early 2017, however, government sources indicated that this position is being reconsidered. Most major countries aside from the United States have done so already, so Japan's move seems reasonable; however, it also signifies that Japan has become a follower rather than a leader in regional (financial) initiatives.

Citation:
LDP executive says Japan needs to soon join the AIIB, The Asaki Shimbun, 16 May 2017, http://www.asahi.com/ajw/articles/AJ201705160020.html

Luxembourg

Score 6

Since the opening and creation of the single European market in the 1970s, Luxembourg has been the most important actor in the European debt capital market, playing a major role in stimulating the international financial architecture.
Luxembourg performed relatively well in the global financial crisis. After saving DEXIA and Fortis, two domestically important banks, tax revenues have begun to rise again in recent years. But as a small country, Luxembourg’s economy remains strongly influenced by the general economic climate and international trends.

Luxembourg is a major financial center, with the banking and financial services industry (non-bank financial institutions), directly and indirectly contributing an estimated 30% to GDP. Consequently, the country was exposed to the effects of the economic crisis within the European Union. Luxembourg’s treatment of offshore accounts and capital deposited by non-resident customers came under international scrutiny during that period. As a consequence, Luxembourg has developed new clusters, such as FinTech (new financial technology), to complement the traditional fields of work of the financial industry.

In the 2017 Index of Economic Freedom, Luxembourg is ranked 14th out of 186 countries. In the 2017 World Bank’s Doing Business report, Luxembourg ranked 59th out of 190 countries (2016: 61), far behind Denmark (3), Germany (17) and France (29). Reflected in these rankings is the perception that Luxembourg has difficulties encouraging the founding of start-ups and creating new professions. In response, Luxembourg set up several opportunities for coworking and created innovation centers to support start-ups.

After climbing two places in 2016, Luxembourg made a swift improvement of 4 places in the 2017 Global Financial Centers Index and ranked 14th out 108 global financial centers, which makes it Europe’s fourth most important financial center after London, Zurich, and Frankfurt, improving rapidly from 19th to 11th place.

Citation:
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Mexico

Score 6

Given its experience with severe financial crises, Mexican governments over the last two decades have been keen to improve the regulation of the domestic financial sector. As a consequence, domestic financial regulation improved substantially, though it remains far from optimal. Mexican governments have also embraced an international effort to halt financial flows related to illegal drug production and trafficking. As part of its anti-drug smuggling policies, for example, money laundering has become more difficult. Yet as the prevalence of destabilizing domestic drug-related conflicts shows, the government is far from achieving its internal goals related to drug production and money laundering.

Despite government efforts, dealing with major financial inflows from illegal drug-related activities remains a major challenge in Mexico. On the positive side, the performance of Mexican banks (e.g., regarding the percentage of non-performing loans or banks' risk-weighted assets) is currently well above the OECD average, according to IMF statistics. There may indeed be a danger of going too far the other way, since the lending policies of the country's largest financial institutions have sometimes been criticized as being too conservative, constraining domestic economic growth.

The government has also more actively participated in international trade negotiations in an attempt to diversify the Mexican economy and reduce its dependence on the United States. While the government has had some success in this respect, the Mexican economy remains heavily dependent on its northern neighbor, an issue that is seen as increasingly problematic due to the Trump administration's threats to withdraw from NAFTA.

New Zealand

Score 6

As a globally oriented country with a high degree of international economic integration, including financial market integration, New Zealand has a strong interest in promoting a stable, efficient and transparent international financial system. There is a commitment to preventing criminal financial activities, including tax evasion. The Inland Revenue department's audit activities focus on cases in which multinationals appear to be avoiding taxes. In May 2016, it was announced that New Zealand had joined an OECD initiative to allow all participating tax jurisdictions to exchange information on the economic activity of multinational corporations among participating countries. In June 2017, New Zealand signed the OECD Multilateral Convention to Implement Tax Treaty-Related Measures to Prevent Base Erosion and Profit Shifting (known as the Multilateral Instrument). However, New Zealand is too small a player in the international arena to contribute proactively to the regulation and supervision of financial markets. It concentrates on regional arenas, such as the Asia-Pacific Economic Cooperation (APEC). Even here, the country has only limited ability to shape the regulatory process within multilateral institutions.

Citation:
NZ joins country-by-country reporting. Tax Policy – Inland Revenue. 18 May 2016 (http://taxpolicy.ird.govt.nz/news/2016-05-18-nz-joins-country-country-reporting) (accessed September 17, 2016).
New Zealand signs OECD Multilateral Instrument. Beehive. 8 June 2017. (https://www.beehive.govt.nz/release/new-zealand-signs-oecd-multilateral-instrument) (accessed 1 October 2017).

Poland

Score 6

Poland has not been an agenda-setter with regard to the regulation of international financial markets and this has not changed with the current government. Poland's previous PO-PSL government supported the idea of a financial-transaction tax, but opposed that of an EU banking union, PiS has a similar or even more nationally oriented stance in this respect. Poland's financial sector has remained stable despite rapid expansion, as various stress tests have demonstrated. A new act on macro-prudential supervision over the financial system went into effect in November 2015 that widens the mandate of the Financial Stability Committee.

Romania

Score 6

Romania continues to be an active participant in the EU, the IMF and other international fora. The country's ability to lead in these fora is limited by its rightful focus on internal economic development and stability.

Czech Republic

Score 5

The Czech Republic is not a major player in international financial affairs. Its main banks are foreign-owned and their independent international involvement is very limited. Nor did it participate in reforming the international financial system, preferring to see itself as a follower of initiatives developed elsewhere. While the

Sobotka government made a turn from the euroskeptic policy of previous governments toward a more mainstream view of EU economic policy, neither the Ministry of Finance nor the Czech National Bank (the central bank) have come out in favor of an accession to the EU Banking Union. Both fear that such an accession would restrict national competencies and lead foreign-owned banks to take deposits from their Czech branches to cover losses elsewhere. The Sobotka government also avoided formulating an explicit deadline for entering the European Monetary Union – opinion polls show a large proportion of the population opposed – but referred to 2020 or 2021 as possibilities. According to the governor of the Czech National Bank, the Czech Republic is generally ready to adopt the euro. There remains a significant gap between the Czech Republic and the euro zone in terms of nominal price and income levels. One step that may help to slowly reduce this gap is a decision by the Czech National Bank in April 2017 to remove the upper limit of the euro exchange rate after three and a half years.

Iceland

Score 5

In part because of its small size, Iceland has never made a substantial contribution to the improvement of the international financial, or other comparable international institutional, framework. However, the government has taken significant steps to address the extreme instability in the domestic financial system.

First, the government in office during 2009-2013 significantly strengthened the Financial Supervisory Authority (FME) and established a Special Prosecutor’s Office. The Special Prosecutor’s Office was charged with investigating legal violations related to the financial crash, including breach of trust, insider trading, market manipulation and false reporting. By late 2017, the Supreme Court had sentenced 35 individuals to a total of 88 years in prison for offenses relating to the economic collapse. The Special Prosecutor’s Office was merged with the District Prosecutor’s Office at the end of 2015 under the directorship of the former Special Prosecutor.

The government has sought to strengthen financial supervision by encouraging the FME to impose tougher standards. For example, prior to the crash, banks commonly provided loans without collateral, but this practice has since stopped. It was common practice to extend loans to well-connected customers to purchase equities, with the equities themselves as sole collateral. Presumably, this is no longer being done. However, other practices have not ceased. For example, banks continue to be accused of acting in a discriminatory and nontransparent manner with some customers allowed to write off large debts, while others are not, without appropriate justification for discriminating among customers. A number of Iceland’s most prominent business figures avoided bankruptcy following the crash because banks annulled their losses. Under new management, since the proactive director of the FME was replaced in 2012, the FME lacks strong and clear leadership. The FME has once again adopted a passive, non-intrusive strategic approach. According to a February 2017 poll, conducted by opinion research firm Gallup, the banks are the least trusted institutions in Iceland. Only 14% of respondents expressed confidence in the banks, compared with 22% confidence in the parliament, and 19% confidence in the FME.

The present government has yet to propose a plan for the reorganization of the banking system. This means that the future ownership structure of the banks remains uncertain, particularly the division between private and public ownership as well as between foreign and domestic ownership. Foreign competition in the banking sector remains absent, offering huge monopoly rents to bank owners, a unique feature of Icelandic banking which helps explain why bank ownership is so coveted among Iceland's clan-based business elite.

Citation:
http://www.gallup.is/nidurstodur/traust-til-stofnana/

Portugal

Score 5

Portugal is a peripheral country and has not sought to contribute actively to the effective regulation and supervision of the international financial architecture. For a number of years, the risk associated with the country's high level of public debt led the government to focus overwhelmingly on achieving fiscal sustainability and financial stability. More recently the Costa government has sought to play a bigger role in contributing to EU debates on regulation, but the country remains relatively poor in the EU context.

South Korea

Score 5

While the vulnerability of the Korean financial system has declined considerably since the 2008 crisis, risks still remain, particularly with regard to the country's weakly regulated non-bank financial institutions (NBFIs). Household debt, largely resulting from real-estate price inflation over the last two decades, is a huge problem. With regard to international engagement, South Korea is implementing international financial-regulation rules such as the Basel III framework. Although it is a member of the G-20, it does not typically take the initiative or actively promote new regulations internationally. Under the Park Geun-hye administration, South Korea became less globally oriented, focusing instead on bilateral relations with the United States and its direct neighbors in East Asia. Thus far there are few indications that the Moon administration will change this focus. Nor, at least as of the time of writing, had a clear strategy emerged indicating how Korea would seek to contribute to the advancement of international institutions such as the G-20. The Moon government was fully occupied with domestic issues in its early months. However, in the course of addressing the Park Geun-hye and Choi Soon-sil scandals, the Korean government will be actively engaged in combating money laundering and monitoring cross-border financial flows.

Citation:
IMF. Republic of Korea : Financial System Stability Assessment. May 20, 2014.
Country Report No. 14/126 https://www.imf.org/en/Publications/CR/Issues/2016/12/31/Republic-of-Korea-Financial-System-Stability-Assessment-41569.

Bulgaria

Score 4

As a member of the European Union and the European System of Central Banks, Bulgaria participates in the discussions on the regulation of international financial markets. However, the country has not been among the proactive promoters of changes, even though the 2014 banking crisis in Bulgaria has somewhat increased interest in the issue. While successive Bulgarian governments have been interested in securing the country's membership in the European banking union, they have not paid much attention to the actual architecture of this union.

Croatia

Score 4

The accession of Croatia to the EU has brought greater integration of the financial system. The EU's single passport system for financial institutions allows banks regulated by their home country authority to set up branches in Croatia. Previously, foreign banks were only allowed to establish subsidiaries under the regulatory supervision of the Croatian National Bank. With the passing of domestic regulatory authority from the Croatian National Bank to that of the foreign banks' home country, an important protection for the Croatian financial system has been removed. This renders the Croatian financial system more vulnerable and increases the risk of cross-border contagion in the event of a new financial crisis. To date, only a limited number of foreign bank branches have been established in Croatia, which is a potential risk to future financial stability. While Croatia is rather vulnerable to developments on the global financial markets, its governments have not played a major role in global attempts at reforming the international financial system. Nor have they cracked down on money laundering. Croatia is part of the "Balkan route," a major trade corridor where trade-based money laundering takes place, and where private and state-owned companies have been linked to money laundering activities. The Anti-Money-Laundering Office is understaffed and the rate of convictions for money-laundering offenses remains relatively low.

Cyprus

Score 4

Cyprus has developed as an important financial center since the 1980s, and effectively monitoring the market and enforcing international standards has been a major challenge. A regulatory framework assigns bodies with specific tasks, such as the Securities and Exchange Commission and the Unit for Combating Money Laundering (MOKAS). The money-laundering risks have not changed since 2005 and are considered to be low; risks and vulnerabilities mainly emanate from international business activities, in particular banking and real-estate transactions. Legal constraints regarding dealers in foreign currency, restrictions on foreign ownership of property and the limited role of cash in transactions minimize laundering risks.

Amendments to laws on money laundering and terrorist activities aimed at aligning with EU directives. These further strengthen the deterrent regime, enhancing the powers of financial-sector-supervisory authorities to ensure legal compliance and seize property acquired through unlawful activities. Since January 2017, Cyprus is a signatory to the Common Reporting Standard for information exchange.

Gaps in effective supervision of designated non-financial businesses and professions (DNFBPs) that existed prior to April 2013, particularly with regard to trust and company-service providers and the real-estate sector have been reviewed for remedy.

Bank-oversight mechanisms have also been enhanced so as to avoid problems common in the past, when institutions simply failed to follow rules governing large exposures, minimum capital and liquidity, taking on unsustainable levels of non-performing loans. Measures implemented since 2014 aim at protecting depositors and minimizing systemic risks.

The IMF insisted in 2015 that Cyprus implement further reforms to strengthen banking- and financial-sector oversight under the provisions of the 2013 MoU. These recommendations have not been renewed, an indicator that good progress has been made. This was confirmed by assessments from Transparency International and the Bank of Cyprus.

Citation:
1. Updating Cyprus Money Laundering Record, InCyprus, 4 March 2017, http://in-cyprus.com/updating-cyprus-money-laundering-record-2/
2. Cyprus and Money Laundering http://www.bocblog.com/2017/05/10/cyprus-continued-wins-against-money-laundering/

Hungary

Score 4

Being neither a member of the euro group nor a big lender, Hungary’s role in international financial markets is limited. However, the stabilization of the Hungarian banking system continued in 2016 and 2017 and, in a way, contributed to the stability of the global financial markets. At the same time, the international reputation of the National Bank of Hungary has suffered from the involvement of its governor György Matolcsy in various scandals. Due to the coming parliamentary elections in April 2019, the issue of euro membership has come to the fore. While the democratic opposition, unlike Jobbik, has argued for a quick entry, the Orbán government has taken a more cautious approach.

Citation:
Józwiak, V. (2017): Prospect of Euro Adoption in Hungary. The Polish Institute of International Affairs, Bulletin No. 97, Warsaw (http://www.pism.pl/publications/bulletin/no-97-1037).

Slovenia

Score 4

Compared to most other East-Central European countries, the degree of foreign ownership within the Slovenian financial sector has remained low. Like its predecessors, the Cerar government has not contributed actively to improving the regulation and supervision of international financial markets. Instead, it has focused on addressing financial problems within the Slovenian banking sector by implementing the bad-bank scheme devised by the Janša government. Established in March 2013, the Bank Assets Management Company (BAMC) has taken over non-performing loans in exchange for bonds backed by state guarantees.

Greece

Score 3

Greece, a rather small European economy which is still in the midst of a crisis of its own, is not in a position to take initiatives to monitor the global economic environment. In its capacity as an EU member state, Greece has participated in EU-driven efforts to regulate the global economic environment. Greece has also argued in European forums in favor of a more regulated system of financial markets.

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