This revised note, which will be the basis for the work programme proposals to the Secretary-General, has been prepared in consultation with the Bureau to take account of comments received from delegations.
I. Introduction and conclusions

1. Under the Organisation's procedures, committees are required every two years to formulate, against the background of the Organisation's broad priorities [see C(2000)36], a detailed work programme for the upcoming two-year period, i.e. 2001-2002. The bi-annual budgetary process allows for "mid-term corrections" and hence decisions made at this time can be revisited in 2001. The Committee is reminded that its decisions on the main lines of its programme of work are in the nature of proposals. Final decisions are the prerogative of the Council. On the basis of the Committee's deliberations, the Secretariat will prepare the relevant sections of the Proposed Programme and Budget of the Organisation for 2001-2002, which the Secretary-General is to submit to the Council.

2. In preparing the present note, the Secretariat has been guided, inter alia, by the discussions held by the Committee in 1998, which resulted in the endorsement at the December 1998 session of the note by the Bureau on "Improving the Working Methods of the OECD Committee on Financial Markets" [see DAFFE/CMF(98)37]. Amongst the seven proposals endorsed in the context of that exercise, the first three are of direct relevance for the scope and content of the work programme:

- Proposal 1: The Committee's work will be focused on structural and longer-term aspects of the functioning of financial markets. In this context, a brief review of conjunctural and current events will normally be included in the Committee’s meetings -- primarily as a monitoring device for identifying relevant structural policy questions.

- Proposal 2: The main direction of the Committee's work will be policy-relevant analysis, seeking to learn from quality research and to discern best practices, often using cross-country comparisons.

- Proposal 3: The Committee normally will meet in plenary session twice a year, in April and in October. Where it is efficient, ad hoc expert groups may be employed to assist the Committee with background research or other meeting preparation.

3. Over the past several years, the Committee has interpreted its general terms of reference -- "the study of measures intended to improve the operation of national financial markets and the international financial market" -- as implying that its activities should be structured along the following priorities:

- Support policies to improve the efficiency of financial markets while contributing to structural adjustment and minimising systemic risk;

- Promote the liberalisation of international trade and market access in financial services;

- Assess the impact of regulatory regimes on the functioning of financial markets and facilitate the process of setting efficient rules for financial markets;

- Improve financial statistics;

- Promote the integration of non-Member countries in the international financial system.

Although these priorities were not discussed in detail on the occasion of the CMF consideration of the Bureau's note in late 1998, the thrust of the discussion suggested that they remain of major relevance in determining the Committee's work programme.

4. In light of the positive experience gained in 1999 with canvassing Delegations' views on potential projects suitable for consideration by the CMF, in a letter dated 14 January 2000 the Secretariat invited
delegates to put forward proposals -- possibly fleshed out with regard to the objectives of the project, its scope and content -- on the activities to be carried out by the CMF during the period under consideration. Several responses to this request have been received, which are presented below.

5. The Committee has been requested in the past to state its priorities concerning those activities that should receive greatest emphasis when the work programme is transmitted to the Secretary-General and to Council. This requirement is of even greater importance than in the past for the reasons indicated in Section IV.

6. At its meeting on 5 April, the Committee considered an initial draft of this note and held a tour de table to determine delegates’ views on the priorities to be attached to the proposed discrete projects. In accordance with the agreed procedure, a revised version was submitted for consideration by the Committee under written procedure. The present text, which will form the basis for the proposals to the Secretary-General, has been prepared in consultation with the Bureau to take account of comments received from delegations.

7. A clear picture of delegates’ preferences emerged from the tour de table. In addition to the issues related to “financial contagion” (see paragraph 25), three projects received very strong support from a majority of delegations (Group 1): experiences in resolving and restructuring weak financial institutions; cross-border trade in financial services (internet); and consolidated regulation of financial services. Three other projects can be ranked as of middle priority (Group 2), with the first two receiving relatively stronger support: changes in bond market supply; the markets for risk capital; and corporate governance and financial markets. Finally, the remaining projects were supported only by a small number of delegates.

8. The following conclusions can be drawn from the prioritisation exercise:

- First, on the assumption that the Committee will be allocated the same baseline budget as in 2000, it would be possible to carry out, in addition to the Committee’s "core activities", the discrete projects included in Group 1 as well as the first two projects in Group 2. The specific modalities -- including timing and the form(s) of support that could be provided to the Secretariat -- of each project will have to be discussed at a future meeting of the Committee when the Secretariat will be in a position to put forward more concrete proposals on the basis of Council’s decisions on the Organisation’s work programme and budget.

- Second, in the event of a 3 per cent reduction in resources, one of the two middle-ranking projects would have to be scrapped, at least for the time being. On the basis of the expression of interests made at the tour de table, this would be the case for the project on the markets for risk capital.

- Third, the Council’s decision on resource reallocation requires Committees to decide towards which activity any increased resources should be directed. On the assumption that such an increase should go towards one of the Committee’s core activities, the work on “institutional investors” (see paragraphs 13-16), which incorporates an important contributory element to OECD horizontal activities, would be the most suitable candidate to benefit from any additional resources.

II. On-going Core Activities

9. The work of the Committee is supported by the activities of its two existing Working Parties on Debt Management and on Financial Statistics (which is serviced by the Financial Statistics Unit) -- whose proposed work programmes are discussed in paragraphs 17-19 and 20-23, respectively. It is also worthwhile recalling that the plenary sessions of the CMF have traditionally been preceded by an informal
meeting of delegates with representatives of the financial services industry (so-called "bankers’ meeting"). The nature of these meetings -- with heavy emphasis on informality, frankness (off-the-record) of discussion, and flexibility in the choice of the topic to be addressed and of the private sector representation -- has proven to be of high value to the Committee in its analysis of structural developments in financial markets and the attendant policy issues. The response of the private sector to invitations to attend these meetings has consistently been very positive (in spite of the inherent difficulty of coming to Paris for a 3-hour session) and this has enabled the Committee to be kept abreast of market participants’ views on the evolution of financial markets and the structural changes underway in the financial industry. As in the past, such meetings will be arranged to provide background for the CMF’s analysis and research in one of the structural items to be discussed in the plenary session.

10. Regarding the Committee’s core activities, there are four points that deserve to be briefly mentioned. First, the CMF has been called in the past to participate in certain "horizontal" or multidisciplinary activities of the Organisation -- the projects on ageing populations, corporate governance and regulatory reform being the most recent examples. Horizontal projects are agreed by the Council in the context of the OECD-wide work programme and the possibility exists that CMF involvement will be required in the future as well. Second, the surveillance role of the CMF (see activity 1) is carried out in close co-operation with other OECD Directorates and other international bodies, several of which have observership status in the Committee -- paying particular attention to the risks of duplication. A special case is represented by the Financial Stability Forum, of which the OECD is a member. As agreed by the CMF in 1999, the Secretariat provides a regular briefing on the activities of the Forum, which permits all members to be apprised of the Forum’s work programme. As in the past, the work of the CMF will serve as an input to projects carried out in other international fora and, in turn, the Committee may wish to integrate into its own activities, and follow up as appropriate, the results of the research of these other bodies. In this connection, the work underway in the Group of Ten’s Working Party on Financial Sector Consolidation is of particular relevance. Third, the review of policy measures affecting market access for institutions, borrowers and investors contributes to the Committee’s efforts to promote the liberalisation of financial services with regard to both cross-border transactions and foreign participation in national markets. In the context of the present work programme, a proposal to address specific financial liberalisation issues is set forth in paragraph 27 below. Finally, the present note does not cover outreach activities conducted under the auspices of the Committee. An overview of such activities planned for 2000 is to be found in DAFFE/CMF(2000)7. The Organisation’s integrated programme of operational activities with non-Members will be discussed by the OECD Committee on Co-operation with Non-Members (CCN) later this year. In the area of competence of the CMF, it is expected that such activities will continue to focus on structural issues in securities markets, government debt management, institutional investors and financial statistics.

Activity 1: Surveillance of Structural Developments in Financial Markets

11. This activity covers work on structural, organisational and regulatory issues related to the functioning of financial systems. It encompasses surveillance of financial reforms and innovations in Member countries with a view to increasing understanding of national policies and assessing their implications for promoting efficiency, improving investor protection and containing systemic risk. It should be recalled in this regard that the 1998 discussion on the CMF working methods clearly showed that delegates wished to focus the Committee’s work on structural and longer-term aspects of the functioning of financial markets, with the discussion of macro/monetary/conjunctural issues and of major current events being seen as a useful monitoring device for anticipating relevant structural policy questions.

12. It is proposed to continue conducting this activity in the framework of the Tour d’Horizon segment of the CMF meetings, which the Committee agreed should be held in the first morning of the plenary session [see Proposal 6 in DAFFE/CMF(98)37]. The in-built flexibility of the Tour d’Horizon’s
new structure as agreed in 1998 provides scope for addressing those topics of particular relevance at the
time of the meeting and to have an initial round of discussions on structural issues that may deserve to be
analysed in greater detail at a later stage, possibly in the form of discrete projects. It is also proposed that
in the future the CMF Bureau be more closely associated with the selection of the topics to be tabled for
consideration. As agreed in December 1998, the outcome of the discussion will be reflected in a
"monitoring report" to be prepared by the Secretariat and circulated to all delegates within two weeks after
the meeting. Finally, the supporting background notes for the Tour d'Horizon will provide inputs to
articles to be included in Financial Market Trends.

Activity 2: Institutional Investors

13. The broad issue of "institutional investors" (IIs) has been an important component of the
Committee's work programme for a number of years. A key consideration in this regard is that this is a
topic in which the CMF took the lead in research and discussion and that is not covered in any systematic
manner in other organisations. In addition, several aspects of the IIs problematique have been of
considerable importance in the context of the Organisation's work on the implications of ageing societies.

14. The CMF's previous work on the subject culminated with the publication of a major study
(Institutional Investors in the New Financial Landscape) in 1998, which reflected the discussions on the
topic within the Committee. Another major output was the establishment of a statistical database that has
been maintained and expanded over the years.

15. At the time of the discussion of the 1999-2000 work programme, it was felt that, in view of the
need to focus on a number of other projects, it would be appropriate to mark a pause in this area with a
view to reverting to it in 2-3 years to take stock of new developments and revisit some of the key policy
issues already discussed in the light of more recent experiences. In the meantime, the II sector has
continued to be one of the most dynamic components of the financial systems in the OECD area and, as
recognised in the context of OECD outreach activities [see, for example, DAFFE/CMF(99)29 and
DAFFE/CMF(2000)10], issues related to IIs have moved up in the policy agenda of many non-Member
countries as well. Therefore, the time would seem ripe for the CMF to resume work in this field. To this
end, the Secretariat will prepare an outline of the project, including a menu of options for topical policy
issues from which delegates could choose the most relevant from the perspective of the Committee. The
outline will be accompanied by an overview of significant recent trends and developments in the industry
as well as of regulatory changes impacting on them.

16. As noted earlier, the issue of institutional investors has represented an important contributory
element to OECD horizontal activities, particularly in the context of the report on Maintaining Prosperity
in an Ageing Society, whose findings and recommendations were discussed at the 1998 OECD Ministerial.
The CMF considered at the April session a report on "Progress in Implementing Reforms in an Ageing
Society" [DAFFE/CMF(2000)12], which is a follow-up to the Maintaining Prosperity report and which
includes proposals for future work in the OECD. Moreover, a comparative study of retirement income
policies in nine countries will be completed in 2001. It is to be expected, therefore, that the CMF be called
to contribute to this exercise. In addition, the new Working Party on Private Pensions of the Insurance
Committee has launched projects related to private pensions issues which will deserve co-operation with
the CMF. This is particularly the case for the projects on competition in private pension markets. The
work programme document DAFFE/AS/PEN(99)1 makes explicit reference to pensions related activities
which should be conducted in co-operation with the CMF, i.e. "financial issues related to the development
of adequate financial instruments for private pension markets, the annuitisation process and proper
financial infrastructure". The Insurance Committee has recently agreed on follow-up work related to the
regulation of investment by insurance companies and pension funds, which will deal with several issues
relevant for the CMF, including comparability and transparency of investment valuation methods,
maturities matching, as well as a survey of the implementation of the "prudent-person" principle across OECD Member countries and analysis of its major characteristics and related policy issues [see DAFFE/AS(98)2/REV3]. A possible result of this work would be to establish “best-practices” in the areas investigated. The Insurance Committee is also conducting research on issues of financial convergences between banks, insurance companies and pension funds, which may call for further co-operation with the CMF.

Activity 3: Public Debt Management and Securities Markets

17. This activity is carried out by the Committee’s Working Party on Debt Management which, in line with its terms of reference, has met once a year since 1981 "to discuss debt management problems of common interest". In the context of the discussion of its work programme in July 1998, the CMF agreed that additional support should be given to the Working Party [see DAFFE/CMF/M(98)2/REV1, item 9] as well as that the Working Party should report back to the CMF on its work once a year. This will be done by making available to the Committee a note on "Structural developments in public debt management and government securities markets" as well as "aide-memoires" of the discussion on topical issues covered at the Working Party's annual meeting.

18. A Steering Group, currently consisting of debt managers from five Member countries, plays an active role in shaping the Working Party's proposed work programme. For the period under consideration, the focus of this activity would be on the following issues:

☑ Risk management practices by debt managers;
☑ Survey of, and analysis of policy issues related to, national debt composition and duration;
☑ Implications of the use of electronic trading and communication systems for government securities;
☑ Assessment of the experience with index-linked securities;
☑ Consequences of budgetary surpluses for debt management and government securities markets, including buy-back and switching programmes;
☑ Policies and techniques for enhancing liquidity in government securities markets.

To support its discussion on these special topics as well as to facilitate the identification of new trends and issues, the Working Party undertakes a Tour d'Horizon on changes in government debt management techniques and practices and in government securities market operations. The Working Party’s analysis of changes in the government securities markets will constitute an important input to Project 5 (see paragraphs 31-32).

19. Three other projects deserve to be mentioned. First, the Working Party plans to pay greater attention in the future to making publicly available the results of its work, particularly in Financial Market Trends. The Steering Group will advise the Secretariat in choosing and preparing studies for publication. Second, the Secretariat will prepare, with the assistance of Working Party members, an up-date of the OECD study on "Government Securities and Debt Management in the 1990s" (so-called "Green Book") with a view to present in a consistent and concise manner OECD countries’ best practices in this key policy area. Finally, the Working Party is providing assistance in the construction of a new database on government debt statistics (see paragraph 23).
Activity 4: Financial Statistics

20. The objective of the work on financial statistics, which is carried out by the Financial Statistics Unit, is to contribute to the Organisation’s aim of deepening the knowledge of Member countries’ financial systems and to permit a better understanding of the interactions between the "real" economy and financial activities. Timeliness for updating, processing and disseminating statistics, improving the quality and international comparability of the data and adapting them to the evolving requirements of the Committee and other users continue to be high priorities. In this respect, the Secretariat will pursue its efforts for the revision of the coverage and the content of the work on financial statistics. Very close co-operation will be maintained with other international bodies, in particular the BIS, ECB, EUROSTAT, IMF and the World Bank, to avoid overlaps, to co-ordinate the efforts to achieve international comparability in data collection and dissemination, and to promote international harmonisation of statistical concepts and methodologies.

21. Against this background, the Unit will maintain, and make efforts to improve where necessary, the databases listed in paragraph 23. The Unit will continue its work on methodological issues through its ongoing efforts for international harmonisation of financial statistics and will undertake special studies to clarify statistical concepts (e.g. accrual accounting), and the statistical treatment of financial instruments (e.g. repurchase agreements, hedge funds.). These studies will be supported by the exchange of national experiences of Member countries. The Unit will also make efforts and deploy resources for the implementation of new information technology procedures required for electronic data dissemination through Internet to comply with the new OECD policy in this field. Finally, the Unit will continue to provide technical assistance to non-Member countries, particularly in the area of Foreign Direct Investment statistics.

22. These statistical activities are supported by the Committee’s Working Party on Financial Statistics, a unique forum for consultation and co-ordination among a wide range of financial experts from OECD governments and international organisations. The Working Party will give priority to work on methodological issues and to perform its editorial functions for the production of various statistical publications. Moreover, it will provide expertise for the clarification of international methodological standards and for their practical application by national compilers, and it will monitor new statistical requirements particularly in the light of developments in global markets. The Working Party will also contribute substantially to the preparation of the OECD globalisation indicators (“globalisation manual”), namely on the chapter on foreign direct investment.

23. The Unit will conduct the following work in 2001-2002 under the auspices of the Working Party:

- National financial accounts -- The underlying methodology for national financial accounts (flow of funds and outstanding assets and liabilities) will be revised to bring them into line with the standards set by the System of National Accounts 1993. The Secretariat will take this opportunity to improve the coverage and to formulate new time series to meet the growing requirements of analysts. This work will be conducted in close co-operation with the ECB and EUROSTAT. The project will also incorporate the analytical requirements of the IMF and World Bank as a contribution to the surveillance initiative for establishing meaningful macro-prudential indicators to strengthen the health and stability of financial systems.

- Bank profitability -- The Secretariat will continue compiling statistics on financial statements of banks and will ensure that methodological country notes are kept current. Moreover, the Secretariat will take the necessary steps to improve the timeliness, frequency and the coverage of this unique set of statistics with a view to contributing to the above mentioned IMF/World Bank exercise on macro-prudential indicators. Particular attention will be paid to the improvement of off-balance sheet
information to take account of the revised recommendations of the Basel Committee on Banking Supervision.

✓ Institutional investors -- The Secretariat will continue the annual collection and dissemination of the statistics and will explore the possibilities for improving the statistics on the portfolio composition of institutional investors’ financial assets, e.g. on cross border portfolio transactions, as well as the classification of categories of institutional investors.

✓ Funded pension schemes -- The objective of the exercise is to compile internationally comparable statistics on all types of funded pension schemes in the OECD area. In the absence of clear recommendations by existing international methodological manuals, first steps were taken towards the harmonisation of basic methodological concepts. Nevertheless, given the large diversity of funded pension schemes in Member countries, the exercise will require substantial additional efforts for implementing comprehensive statistical series. The results of the work will be published and the database will be maintained for regular dissemination of the statistics.

✓ Government debt statistics -- Conceptual work for compiling statistics on central government debt instruments is underway. This exercise will respond to analytical shortcomings of harmonised statistics on government borrowing needs and the composition of the government debt for the OECD area. This exercise will be co-ordinated with the Working Party on Debt Management. It is planned to disseminate these new series on an annual basis.

✓ Privatisation proceeds -- The statistics on privatisation operations in OECD countries will be disseminated more widely to the public at large given the high demand for such data. An Internet web site will be organised jointly with the World Bank, which compiles similar data for non-OECD countries. Data content will be reviewed to complete missing components in individual country information and new programmes will be developed to implement the technical vehicles for data dissemination.

✓ Foreign direct investment -- It is to be noted that the Unit plays a major role in supporting the activities of the Committee on International Investment and Multinational Enterprises (CIME) through the collection, processing and dissemination of the OECD statistics on foreign direct investment. Moreover, the Unit, under the auspices of the Working Party, is responsible for the revision and clarification of the statistical methodology described in the OECD Benchmark Definition of Foreign Direct Investment. Keeping in mind the complexity of the statistical treatment of this category of foreign investment, the Working Party will undertake a series of consultations to broaden the Benchmark by providing additional operational guidelines. This work will be based on the results of the joint exercise with the IMF on the Survey of Implementation of Methodological Standards for Direct Investment. The Secretariat will set up a network of experts on foreign direct investment statistics.

III. Discrete Projects

24. The following paragraphs present an outline of the projects that were considered by the Committee at its April meeting. The projects are listed according to the order of priorities that emerged from the tour de table held on 5 April.
Project 1: Financial Contagion

25. At the April session, the Committee considered a paper taking stock of the research that has been carried out on the issue of financial contagion [see DAFFE/CMF(2000)4]. In the ensuing discussion, a number of proposals were put forward for follow-up studies. Such proposals included:

- the increasing importance of mutual funds (or, more broadly, institutional investors) as a source of contagion;
- the possible role of credit rating agencies in spreading and deepening financial crises;
- an investigation of technical tools/instruments that could be used to preserve the functioning of financial markets at times of financial stress;
- the role of moral hazard in financial crises.

Different views were expressed on the pros and cons of the various proposals. In particular, with regard to the first two proposals it was noted by several delegates that, although the topics were certainly of considerable relevance, there was a major risk of duplicating work done in other international fora. In conclusion, a consensus emerged that the Secretariat should prepare a paper on the role of moral hazard for consideration at the October session. On the basis of the discussion in October, the Committee will be in a better position to determine whether any further work would be appropriate. On that occasion, it would also be possible to consider whether it would be worthwhile undertaking a study on financial market volatility spillovers, as initially proposed by a delegate from Canada. The context of such a study would be the observation that there have been numerous examples in recent years of financial market volatility having macro-economically significant impacts. While many financial shocks originate at some specific location, they rapidly propagate across markets and can have important impacts on many other countries. In order to be able to deal effectively with such a phenomenon, it is important to understand the nature of volatility spillovers. The focus of the study would be on: i) what causes volatility spillovers?; ii) are there institutional structures that mitigate spillovers and, if so, what are the attendant costs? and iii) what are the appropriate (ex-ante and ex-post) policy prescriptions? -- it being understood that the study would not cover issues connected with the "international financial architecture".

Project 2: Experiences in Resolving and Restructuring Weak Financial Institutions

26. Details on the background, objectives, scope and content of this study, which has been proposed by the US delegation, can be found in Annex A. At the April meeting, this proposal received strong support by a large number of delegations, several of which indicated that they would be willing to provide information on their own experience in handling distressed financial institutions. There is also a significant volume of literature in the form of case studies of individual countries, although their format and issue coverage tend to differ significantly from case to case. As suggested by the US delegation, the Secretariat will need first of all to carry out some exploratory work on available evidence and present a well-structured outline of the topics to be covered in the cross-country report. Given the lead-time for such a project and taking account of other activities underway, it is suggested that the study could be launched in mid-2001.

Project 3: Cross-border Trade in Financial Services -- Implications of the Internet

27. Following the completion of its report on "Cross-border Trade in Financial Services -- Economics and Regulation" [see DAFFE/CMF(99)22/REV2], the CMF decided, at the October session, to continue work in this area in a different form, although no specific modalities for follow-up work were decided upon. In the meantime, the Secretariat has received a suggestion by the Delegation from Singapore concerning a study on the "Implications of the Internet on Regulation of Financial Services", and...
which could be regarded as a follow-up to the Cross-Border project. The objectives of the study would be to:

- Understand the key regulatory challenges posed by the increasing use of electronic delivery channels for financial services;
- Identify gaps or weaknesses in existing regulatory frameworks, which need to be addressed in regulating online financial service providers;
- Determine whether there is a need to regulate the new intermediaries (such as non-financial service providers).

Suggestions on the objectives, scope and content of the proposed study can be found in Annex B.

28. At the April session, several delegates stressed the importance of assessing the evidence of the effects of the internet, and more generally the e-commerce revolution, on cross-border trade in financial services before examining the public policy implications. There is also an important link with the exercise currently underway on "Future prospects for national financial markets and trading centres" [see DAFFE/CMF(2000)3], which deals inter alia with public policy concerns associated with the increased use of electronic trading platforms. And attention should be paid to avoid duplication with work underway in other fora. The Financial Stability Forum is undertaking a comprehensive mapping exercise drawing on the terms of reference of work in other fora to assess whether and what risks connected with ICT are not being addressed. The FSF will be advised of the relevant projects envisaged by the Committee. As of now, a survey of initiatives on e-commerce would seem to suggest that, although work on regulatory issues is underway in several international groupings (including BIS committees, IOSCO and IAIS), none of them focuses on the specific aspects of the proposed project. In any event, it is clear that close cooperation with these groupings will have to be established during the preparation of the study. The Committee will have to consider in due time the structure of the study and the modalities for ensuring the support of a small group of experts.

Project 4: The Case for and against Consolidated Regulation of Financial Services

29. The purpose of this project, which has been proposed by the Delegation from Singapore (see Annex C), is to consider the merits of consolidated regulation of all financial services firms within a national boundary. Topics for consideration could be: 1) the pros and cons of consolidated regulation; 2) identification of alternative models for regulating conglomerates; 3) experience of countries which have adopted the consolidated regulator model; 4) impediments to consolidated regulation; and 5) governance and accountability of the consolidated regulator.

30. Over the past several years, the Secretariat has collected a significant amount of information on changes in the regulatory framework in Member countries, which has been discussed in considerable detail by the Committee. This would represent a good starting base for the exercise but it is also evident that its value in terms of policy conclusions would be greatly enhanced by the active participation of experts who have been involved in the discussions on the reform of regulatory structures in their own countries. At the April session, a number of delegates indicated their willingness to participate in a small group of experts that would assist the Secretariat in the preparation of the report. Proper attention will have to be paid to the ongoing work of the Joint Forum as well as the results of the study by the G-10 Financial Services Task Force (in which the Secretariat participates).
Project 5: Long-term Effects of Changes in Bond Market Supply

31. A project proposed by the delegate from the Deutsche Bundesbank -- which received considerable support from delegates at the April meeting -- relates to the "long-term effects of changes in bond market supply". As can be seen from the points set out in Annex D, the delegate notes that major changes are underway in the bond markets of the major OECD areas (United States, Europe, Japan), which may have implications for bond markets in emerging countries as well. The Annex lists a number of market and macroeconomic effects that would deserve to be studied.

32. Through the work of the Working Party on Debt Management, the Secretariat has built up expertise on some of these issues to the extent that they pertain to the functioning of government securities markets. Although the scope of the proposed project is broader, such expertise would be helpful in carrying it out. In addition, it seems that a considerable amount of research is underway both in academic and official circles that could be drawn upon and synthesized for the study.

Project 6: Developments in the Markets for Risk Capital

33. The delegate from the Deutsche Bundesbank proposes to undertake a study on "Developments in the Market for Risk Capital". As a general framework for analysis, consideration would be given to the role of risk capital in the process of economic growth. Against this backdrop, the fact-finding part of the study would cover the quantitative importance and institutional features of the market for risk capital focusing on i) the provision of venture capital, ii) specialised market segments for innovative firms, and iii) the reasons for the success of particular markets/instruments. The policy implications section would consider measures to promote the provision of risk capital in OECD countries, including market structure, institutional arrangements, technology, the regulation of markets and intermediaries, and measures in other policy areas.

34. In the Secretariat’s view, this self-contained project -- which was ranked as a middle priority at the April meeting -- would require assistance from national experts (perhaps in the form of a dedicated electronic discussion group) in light of the very rapid evolution of risk capital markets in Member countries. The project could benefit from the arrangement of a "bankers’ meeting" devoted to the subject. It is also worth recalling that a few years ago the CMF undertook work on the issue of venture capital, which resulted in a paper published in *Financial Market Trends* ("Venture Capital in OECD Countries", FMT No. 63, February 1996) and that the Committee has had a long-standing interest in the organisation and regulation of securities markets (Securities Markets in OECD Countries, OECD Documents, 1995).

Project 7: Corporate Governance and Financial Markets

35. At its October 1999 session, the Committee agreed that work should be undertaken on the corporate governance aspects of the collective investment industry with a view to preparing a report for consideration at the October 2000 meeting (this decision was confirmed at the April session). The Committee also agreed that a project on "governance aspects of financial conglomerates" could be launched in the first half of 2001 [see DAFFE/CMF(99)25, paragraph 15], paying attention to avoid duplication of work currently underway in one of the working groups of the Joint Forum. At the same time, it was decided to postpone any decision on whether to undertake a study on the governance of stock exchanges [DAFFE/CMF(99)25, paragraphs 12-13] to take account of the experience gained with the other two parallel projects. The relatively low priority attached to this project by several delegates would seem to suggest that the possibility of any further work in this area should be reconsidered in 2001, when the scope for a mid-term correction of the work programme will be assessed by the Committee.
36. Delegates may wish to note that the Insurance Committee and its Working Party on Private Pensions will undertake a project on governance of insurance companies and pension funds as part of their respective work programmes, with priority being given to pension funds. It has been agreed [see DAFFE/AS/PEN/WD(99)20] that the governance issues will be analysed both from the perspective of the impact of governance by pension funds as major institutional investors and from the perspective of the governance of pension funds by relevant parties. In view of the complementarity with the projects mentioned above, this work will be conducted in close co-operation with the CMF.

*Project 8: Regulatory Barriers to a Single Capital Market in Europe*

37. This proposal has been put forward by the Delegate from the Bank of England. The key issue is the extent to which the Single Market Directives together with EMU have succeeded in creating a fully integrated capital market. The attendant basic question is whether progress towards full integration is being hindered by: i) structural barriers that are likely to persist in the long run; ii) barriers present as of now due to inertia but where the underlying market situation would suggest that they are temporary in nature; and iii) barriers which arise from regulatory practices and, in this latter case, whether this is linked to shortcomings in the Directives. This issue is of interest not only to European countries but to policymakers in other regions as well, reflecting the importance of competing in the eurozone for their own financial institutions, the growing integration of global financial markets, and consideration of the eurozone as a test case for regional financial areas and for the operation of the kinds of regulation that typify the EU. Also, the topic is of relevance for non-EU European countries which do (or will) share the EU regulatory framework.

38. Delegates may wish to recall that some of the points raised above were discussed at a "bankers’ meeting" held in November 1996 which was, however, devoted to the broader issue of market access in the financial area. In addition, the changes that have occurred in Europe since then make the subject more topical in itself. This being said, in light of the comments made at the April session, it is suggested that, rather than undertaking a study, the topic may be tabled for consideration at one of the Committee’s future informal meetings with representatives of the financial services industry.

*Project 9: Financial Market Effects of Guaranteed Rates of Return*

39. In his proposal for a new CMF project (see Annex E), the delegate for the Danish Nationalbank notes that pension funds and life insurance companies have often offered a guaranteed rate of return to customers. While such offers represent a crucial competition parameter, pension funds and life insurance companies take on considerable market risk by offering them. The proposed study would focus mainly on financial market issues. It could include a theoretical description of guaranteed rates of return and the inherent risks in these products as well as a cross-country analysis of experience with guaranteed rates of return. The study could then turn to consider policy implications, including a discussion of potential preemptive policies and corrective ex-post policies.

40. As mentioned in the Danish note, this issue is of importance from the standpoint of institutional investors’ investment behaviour and risk management strategies and of policy relevance with regard to decisions on the regulation and supervision of such institutions. It is to be noted that this topic has been discussed to some extent at a recent meeting of the Solvency Working Party of the Insurance Committee. The CMF may wish to be advised of any further work carried out on this topic by the Insurance Committee.
Project 10: Implications of Credit Risk Modeling

41. This proposal by the Danish Delegation (see Annex F) starts from the observation that financial institutions have developed and implemented a variety of sophisticated models for assessing credit risk at the portfolio level. These models have gained acceptance not only among bankers but also in international fora discussing the future regulatory framework for the banking industry. Greater reliance on a model-based approach to credit risk assessment could result in a more efficient allocation of capital and a more efficient pricing of bank loans, but it could also have a significant impact on the loan market. The study could be based on an analysis of i) different approaches to evaluate credit risks in banks’ loan portfolios, ii) their short- and long-term effects on the market for bank loans, and iii) the experience with credit risk modeling in periods of financial stress.

42. At the April meeting, it was noted that there was considerable risk of duplication with work carried out elsewhere, particularly in the Basel Committee in connection with the current revision of the Capital Accord -- a consideration which induced several delegates to suggest that work in this area should not be undertaken by the CMF.

Work implications

43. The Secretariat’s assessment of the implications in terms of resource intensiveness, the degree of CMF delegates’ involvement and the expected outputs of the various activities/projects mentioned above is set out in Table 1. This assessment is tentative since a key parameter is the precise scope of each activity/project, which will be determined only on the basis of the Committee’s decisions on the matter.

IV. Priorities

44. On the basis of existing resources, and given the time-frame within which the CMF operates, it is evident that not all the projects listed earlier on can be carried out during 2001-2002. This consideration is strengthened by the Committee’s decision that, at each meeting, no more than two structural issues should be considered, obviously in addition to the Tour d’Horizon exercise. Also, past experience suggests that the CMF should retain some flexibility in planning ahead to be in a position to accommodate unforeseen calls on its time and resources stemming, for example, from major developments in the marketplace or requests of contributions to horizontal or other OECD-wide activities.

45. Council has agreed on a new, reinforced system of prioritisation by committees [see C(99)204/FINAL] including the identification of the impact of a possible 3 per cent reduction or increase in resources. The primary objective of the mechanism is to facilitate the identification of high and low priority activities and thereby the scope for potential resource reallocation among (Part I) activities of the OECD. To assist the Committee in its deliberations on this matter, the following budgetary information is of relevance.

46. In accordance with the internal guidelines developed to implement the resource allocation system, the total budget allocated to the servicing of the CMF can be estimated at 6.4 million francs (on the basis of the proposed 2000 budget, that serves as baseline indicator in this process). This total includes the cost of dedicated staff (around 90 per cent of the total), an allocation of DAFFE management costs, and the so-called decentralised financial resources (basically funding for missions and consultants). On this basis, a 3 per cent adjustment comes to less than 200,000 francs.

47. Turning to the linkage between the CMF budgetary envelope and its activities, it must be stressed that it is very difficult to cost each activity individually reflecting both the integrated nature of work in the
Financial Affairs Division and the strong interrelations that exist between certain activities. However, on the basis of past experience the Secretariat considers that the resources implied in the baseline budget would be adequate to carry out the four ongoing core activities and, say, five discrete projects (over a two-year period). As far as the 3 per cent adjustment is concerned, it can be estimated that it would roughly correspond to the marginal cost of a “discrete” project with medium/light resource intensiveness.
<table>
<thead>
<tr>
<th>Activities/projects</th>
<th>Resource Intensiveness</th>
<th>Degree of CMF Delegates’ Involvement(2)</th>
<th>Expected Outputs</th>
</tr>
</thead>
</table>
| A1. Surveillance of structural developments              | H                      | B                                      | ✅ Path-finding for discrete projects
                                                                                               | ✅ Monitoring report
                                                                                               | ✅ Articles in FMT
|                                                          |                        |                                        | ✅ OECD publication
                                                                                               | ✅ Articles in FMT
                                                                                               | ✅ Contribution to horizontal activities
| A2. Institutional investors                              | H                      | SGE/BM                                 | ✅ Reports to CMF
                                                                                               | ✅ Articles in FMT
                                                                                               | ✅ Updating of “Green Book”
| A3. Debt management                                     | M                      | WP                                     | ✅ Reports to CMF
                                                                                               | ✅ Statistical publications listed in paragraph 23
                                                                                               | ✅ Methodological and technical upgrading of databases
                                                                                               | ✅ Enhanced co-operation with national and international statistical bodies
                                                                                               | ✅ Contribution to horizontal activities
| A4. Financial statistics                                | H                      | WP                                     | ✅ Reports to CMF
                                                                                               | ✅ Statistical publications listed in paragraph 23
                                                                                               | ✅ Methodological and technical upgrading of databases
                                                                                               | ✅ Updated “Green Book”
                                                                                               | ✅ Contribution to horizontal activities
| P1. Financial contagion                                 | H                      | (SGE?)                                 | ✅ Secretariat report to CMF
| P2. Resolving and restructuring weak financial institutions| H                      | A/(SGE?)                               | ✅ Report to CMF
| P3. Cross-border trade                                  | H                      | SGE                                    | ✅ Committee’s report
| P4. Consolidated regulation                             | M                      | SGE                                    | ✅ Committee’s report
| P5. Bond market supply                                  | L                      | A                                      | ✅ Secretariat report to CMF
                                                                                               | ✅ Article in FMT
| P6. Markets for risk capital                            | M                      | A/BM                                   | ✅ OECD publication
| P7. Corporate governance                                | M                      | A/BM                                   | ✅ Secretariat report(s) to CMF
                                                                                               | ✅ Articles in FMT
| P8. Single European capital market                       | L                      | BM                                     | ✅ Secretariat report to CMF
                                                                                               | ✅ Article in FMT
| P9. Guaranteed rates of return                           | L                      | A                                      | ✅ Report to CMF
                                                                                               | ✅ Article in FMT
| P10. Credit risk modelling                              | L                      | SGE                                    | ✅ Report to CMF
                                                                                               | ✅ Article in FMT

(1) H = high; M = medium; L = relatively light. Please note that these symbols do not refer to the priority attached to the project.
(2) In the preparatory/development phase.
B = CMF Bureau; SGE = small group of experts; WP = existing Working Party; A = availability to provide information on countries’ experience; BM = dedicated “bankers’ meeting”
ANNEX A

EXPERIENCES IN RESOLVING AND RESTRUCTURING WEAK FINANCIAL INSTITUTIONS
(Proposal by the Delegate from the US Treasury)

Background

Many OECD Member countries (e.g., the United States, Japan, Mexico, Sweden, Finland, Spain, Korea, etc.) have experienced banking crises over the years, which have exacted a considerable toll in economic performance. Fiscal costs to resolve a banking crisis can be quite high, ranging up to 25 per cent of GDP, or more recently in the Asian crisis, even higher. The onset of banking crises presents economic policymakers with considerable challenges: determining the best way to resolve viable and non-viable banks, determining whether and how public funds should be used to recapitalise banks, and the best method to dispose of the bad assets, both in the banks themselves and those that have ended up in public sector hands. A banking crisis involves not only banking regulators, but also central banks, finance ministries, bank resolutions agencies, asset disposal bodies, and legislatures. In some cases, policymakers have delayed their responses to banking crises or taken ad hoc approaches, given the absence of clear-cut best practices for dealing with non-viable banks and their bad assets.

A number of international working groups have addressed various aspects of banking sector weaknesses and crises, as well as the lessons learned. A G-10 deputies group in 1997 developed a set of key fundamentals of a sound banking system and characteristics of a poorly performing one; three G-22 working groups in 1998 developed recommendations to enhance transparency and accountability, strengthen domestic financial systems, and manage international financial crises; and most recently various groups of the Financial Stability Forum have been considering ways to promote international regulatory standards to strengthen financial systems and are now developing best practices for deposit insurance systems. In none of these efforts, however, has there been any systematic study of the question of resolving and restructuring banks and disposing of the bad assets arising from the crisis.

Objectives of the study

The objectives of this study would be to identify best practices for resolving and restructuring weak financial institutions, particularly banks; to catalogue the resolution techniques available to Member countries’ banking authorities; to assess the appropriate conditions for using public funds to recapitalise banking systems; and to evaluate methods for disposing of the bad assets arising from a crisis.

Scope and Content of the Study

Taking account of existing IMF and World Bank literature, the Secretariat would review and develop case studies outlining the experiences of individual Member countries (including for example the United States, Japan, Mexico, Sweden, Finland, Spain, Korea, etc.) in dealing with insolvent financial institutions and their bad assets. The Secretariat would prepare an issues paper presenting the various themes for discussion at a CMF meeting.
ANNEX B

IMPLICATIONS OF THE INTERNET ON REGULATION OF FINANCIAL SERVICES
(Proposal by the Delegation for Singapore)

Objective

This project can be regarded as a follow-up to the ongoing project on "Cross-Border Trade in Financial Services: Economics and Regulation"\(^1\). Its objectives would be to:

- understand the key regulatory challenges posed by the increasing use of electronic delivery channels for financial services;
- identify gaps or weaknesses in existing regulatory frameworks which need to be addressed in regulating online financial service providers;
- determine whether there is a need to regulate the new intermediaries (such as non-financial service providers).

Scope

The study will encompass the regulation of online financial service providers, both domestic and offshore, which provide services to, or solicit business from, residents.

Content

Some issues that could be examined are:

- data collection, and measurement and monitoring of internet transactions – implications for disclosure requirements and risk assessment;
- consumer protection – consumer education, security and privacy concerns, protection against fraud;
- international regulatory co-operation – how it can be enhanced and strengthened, and in which areas in particular;

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\(^1\) The draft report of the project on "Cross Border Trade in Financial Services: Economics and Regulation" had noted that technological advances and the advent of new delivery channels would give further impetus to cross-border trade in financial services. The report also highlighted several issues that increasing cross-border trade in financial services would pose for regulators and supervisors, e.g. prudential issues, consumer and investor protection and promoting competition.
• whether online financial service providers might take excessive risks in order boost their earnings, offset the large amounts spent on advertising and marketing, and justify high stock valuations (currently, e-businesses tend to sacrifice near-term profit for the sake of expanding market share);

• regulatory requirements (e.g. capital adequacy requirements) for internet-only financial service providers, while ensuring a level playing field between traditional and new financial service providers;

• whether "middlemen" (e.g. internet service providers, portals, software or other application service providers) should be regulated as well;

• how to maintain a healthy degree of competition, between traditional financial service providers and new players;

• supervisory enforcement difficulties, and how they can be overcome.
ANNEX C

THE CASE FOR CONSOLIDATED REGULATION OF FINANCIAL SERVICES
(Proposal by the Delegation for Singapore)

Objective

Two major trends in the financial services sector pose challenges to the traditional regulatory approach based on functional activities or product line.

- First, the increasing emergence of financial conglomerates or "supermarkets" is blurring the boundaries that have hitherto segregated financial services providers. The question arises of how these financial institutions could be more effectively regulated on a consolidated basis.

- Second, financial products are increasingly sharing similar characteristics. For example, investment linked insurance policies include income streams that is similar to those of mutual funds. The question then arises how such insurance policies should be regulated and who should be appropriate regulatory agency. Regulators also need to ensure a level playing field in each financial activity, irrespective of the primary functions of the provider (e.g. a level playing field for the provider of an investment-linked insurance product vis-à-vis a mutual fund operator). Can a single consolidated regulator better address the risks and needs arising from this development, compared with the current approach in most countries?

Scope

The study would consider the merits of consolidated regulation of all financial services firms within a national boundary.

Content

Some possible topics for study are:

- the arguments for and against consolidated regulation, weighed against the advantages and disadvantages of regulation of financial institutions according to product line or functional areas;
- identify other alternative models for regulating financial conglomerates;
- the experience of pioneer countries, such as Sweden, Denmark, Norway and the UK, which have adopted the consolidated regulator model;
- potential impediments to consolidated regulation, such as constitutional mandates and legal structures, and how these obstacles can be addressed;
- governance and accountability of the consolidated regulator.
ANNEX D

LONG-TERM EFFECTS OF CHANGES IN BOND MARKET SUPPLY
(Proposal by the Delegate for the Deutsche Bundesbank)

Changes in bond market supply

United States

• Declining volume of outstanding Treasuries.
• Adjustment of rhythm and volumes of Treasury issues; buy back programmes.
• Total repayment of debt until 2013; marketable securities even sooner.
• Traditionally strong corporate bond sector; new role of the agencies (benchmark substitutes); development in the ABS/MBS sector; new products (e.g. Tier 3-capital issues of banks).

Europe

• Declining net-borrowing of European states; prospect of balanced budgets in the near future; shrinking portion of government bonds relative to total outstanding volume; possibility of a US-like development in some member states.
• Booming corporate bond sector (abolition of traditional relationship banking/growing importance of capital markets/increasing transparency in the corporate sector/financing of M&A transactions).
• Jumbo-Pfandbriefe as possible benchmark substitutes? Expected surge in ABS transactions (restructuring of banks’ balance sheets; more efficient use of liable capital).

Japan

• Significant increase in issuance of government securities (As this situation does actually not exactly fit in the context of the topic, one could perhaps present the Japanese situation in some kind of appendix.);
• Japanese capital markets will probably not be excluded from securitisation and therefore the corporate bond sector should see a significant development in Japan as well.

Emerging Markets

The developments in industrialised countries will have implications for the bond market structures of emerging countries as well, although the time horizon remains unclear.
Effects of the Changing Supply Structure

Market effects:

Lack of reference issues for the pricing of spread products

- Hedging with government bond futures becomes more and more difficult;
- New derivative products will emerge (e.g. agency futures).

Swap markets become increasingly important.

Multi-benchmark environment (more than one benchmark, but probably smaller issue sizes).

Requirement for issuers to concentrate on only few large-sized issues.

Lower liquidity.

Higher volatility.

Macro economic effects:

- Growing importance of the credit risk factor (risk allocation)
- Effect of growing disintermediation on banks?
- Effects on interest rates and economic growth?
- Reaction of demand?

Are investors willing to switch their holdings completely in agencies?

What about diversification to other Triple-A borrowers (or lower rated issuers or even into equity)?
ANNEX E

FINANCIAL MARKET EFFECTS OF GUARANTEED RATES OF RETURN
(Proposal by the Delegate for Denmark’s Nationalbank)

Background

Pension funds and life insurance companies frequently offer a guaranteed rate of return to their members. While the guaranteed rate of return undoubtedly is a crucial competition parameter, pension funds and life insurance companies take on a sizeable market risk by offering it.

The guaranteed rate of return basically corresponds to a put option offered to the pension and life insurance beneficiaries at no cost. The put option is usually offered when it is deeply out of the money, but given the long life of the option there is a high potential risk that it gets in the money and obtains a positive value.

In recent years this has been evident in a number of countries, including Japan, Germany, United Kingdom and Denmark where guaranteed annuities offered several years back by pension funds and life insurance companies have become considerable liabilities. This development has been a result primarily of the marked fall in the long-term interest rates below the guaranteed rates of return, the increased life expectancy and the insufficient hedge of the options embedded in the guarantees.

In several countries, the institutions have tried to hedge the embedded options making use for example of equivalent options bought in the financial markets. This has among other things, stimulated the development of new sophisticated derivative products.

In Denmark on the other hand, it is currently under consideration to offer the pension funds and life insurance companies to buy the equivalent options from the Danish State.

Objectives and content of study

The principal purpose of this study would be to analyse financial market and policy issues related to guaranteed rates of return offered by pension funds and life insurance companies.

We believe this topic is relevant to look further into as institutional investors manage an increasing share of private savings and are becoming ever more important players in the financial markets. Hence, when products like guaranteed rates of return offered by these institutions influence their investment behaviour and their risk management strategies it has significant effects on the financial markets. It could also have significant effects on the financial markets if it turned out that these institutions had serious solvency problems because of insufficient management of the risks associated with their products. Such a development could furthermore put the entrusted pension savings at risk.
Thus, understanding the risks associated with guaranteed rates of return is relevant not only from a financial market point of view, as it has great relevance for decisions on supervision and regulation of pension funds and life insurance companies.

The study should mainly focus on the financial market issues. The first part could be a theoretical description of guaranteed rates of return and the inherent risks of this product. The second part, a cross-country analysis of experiences with guaranteed rates of return and the third part, a discussion of policy implications including a discussion of potential pre-emptive policies and corrective ex post policies.
ANNEX F

IMPLICATIONS OF CREDIT RISK MODELLING
(Proposal by the Delegate for Denmark’s Nationalbank)

Background

Within the past years, important advances have been made in modelling credit risk at the portfolio level. The financial institutions have developed and implemented a variety of sophisticated models, such as value-at-risk models especially to manage their trading portfolios. The recent developments in modelling have broadened the scope to the lending portfolios as well.

The new models are designed to quantify credit risk on a portfolio level, and thus have application in control of risk concentration, evaluation of return on capital at the customer level, and more active management of credit portfolios. These models have gained acceptance not only among bankers but also in international forums discussing the future regulatory framework of the banking industry.

In November 1999 the European Commission issued proposals to update the regulations governing how much capital European financial institutions must set aside as a cushion against the risks they are taking. The proposals are closely based on the recommendations of the Basle Committees consultative paper from June 1999.

The purpose of the revised capital adequacy framework is to modernise the existing framework. While the 1988 Basle Accord was an important step forward, new innovations in the capital market have highlighted the need to use more advanced credit risk management tools. Therefore, the proposal from the Basle Committee allows banks to use internal models in determining their capital adequacy as a first step towards possibly allowing the banks to use more advanced portfolio tools at a later stage.

The implications of the new capital adequacy framework

In response to these new developments, a greater reliance on a more model-based approach seems to become the foundation for measurement of regulatory capital adequacy. The final outcome of this process could be a more efficient allocation of capital in the banks and a more efficient determination of the prices on the bank loans. However, the proposal could have important effects on the loan portfolio market.

Today, the broad risk buckets in the 1988 Basle Accord mean that some of the borrowers in the banks pay interest rates that are different from the risks they impose on the banks. In general, it would be expected that low- and high-risk corporate companies pay different amounts of risk premiums but the broad risk buckets mean that the amount of regulatory capital for the two types of companies would be the same.

With the new rules in place and the better ability to differentiate between debtors, banks would therefore impose on debtors a higher price on their loans than today. For some borrowers these new terms would not be acceptable and they would try to find other banks, that evaluate the risk-premiums differently.
Therefore, one would expect that in the short-term perspective, a reloading of loans would take place. Recent experiences show that financial instability often is caused by external shock to the system, i.e. changing regulation, new competition threats, etc. Although the new capital rules could have positive effects in a longer-term perspective with a more accurate pricing, it may very well be that in a short-term perspective the new capital adequacy framework could impose negative effects.

It therefore seems relevant to carry out an analysis, where first of all the different approaches to evaluate credit risks in the banks lending portfolio could be analysed, i.e. KMV model, CreditMetrics, CreditRiks+, etc. Secondly, the long- and short-term effects on the banks lending market, i.e. the possible effects of a reloading of loans between institutions. Thirdly, an analysis of the negative experiences with credit-risk modelling in periods with financial stress could also be analysed.