The G20 and Global Capital Markets
Critical Issues and Analysis

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Contents

Executive Summary 5
Introduction 7
Seoul Action Plan 10
  Monetary and Exchange Rate Policies 10
  Fiscal Policies 10
  Market Intelligence 10
    TMX/Maple Group 10
    NYSE Euronext/ Deutsche Börse 10
    CBOE/NSX 11
  Financial Reforms 11
    Basel III 11
    Too Big to Fail: Systemically Important Financial Institutions 12
    US Market Regulation 13
      Dodd-Frank Act 13
    European Market Regulation 14
    Bank Levies 15
    Hedge Funds, OTC Derivatives, Credit Rating Agencies 15
      OTC Derivatives 15
      Credit Rating Agencies 16
    Implementation 17
    Executive Compensation 17
    Future Work 17
      Shadow Banking 17
      Commodity Derivatives 18
Corruption 20
  Anti-Money Laundering and Terrorist Financing 20

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BACK ISSUES 21
About the G20 22
Executive Summary 23
Introduction 34
Framework for Strong, Sustainable and Balanced Growth 44
International Monetary System 45
Seoul Action Plan 46
  Monetary and Exchange Rate Policies 46
  Trade and Development Policies 48
    Doha 48
    Seoul Development Consensus for Shared Growth 48
  Fiscal Policies 49
  Market Intelligence 51
    Tokyo/Osaka 51
    TMX/Maple Group 51
    TMX/LSEG 51
    NYSE Euronext/Deutsche Börse 53
    ASX/SGX 54
    BATS/Chi-X Europe 55
    Chi-X Australia 55
  Financial Reforms 56
    Basel III 56
      Scope and Post Trigger Instrument 60
      Trigger Event 60
      Group Treatment 60
      Transitional Arrangements 61
      Liquidity Standards 61
      Quantitative Impact Study 62
      Countercyclical Capital Buffer 63
    Too Big to Fail: Systemically Important Financial Institutions 64
    U.S. Market Regulation 69
      Dodd-Frank Act 71
    European Market Regulation 75
      MiFID Review 78
      European Systemic Risk Board 80
    Global Market Regulation 80
    Bank Stress Tests 83
    Bank Levies 86
    Hedge Funds, OTC Derivatives, Credit Rating Agencies 87
      Hedge Funds 88
      OTC Derivatives 90
      Credit Rating Agencies 101
    Implementation 104
    Executive Compensation 104
    Accounting Standards 109

Sample

Future Work 111
Macro Prudential Policy 111
Shadow Banking 112
Commodity Derivatives 113
Market Integrity 116
Consumer Protection 117
Structural Reforms 117
External Imbalances 118
International Financial Institution Reform 120
International Monetary Fund 120
Corruption 122
G20 Anti-Corruption Action Plan 122
Anti-Money Laundering and Terrorist Financing 123
Argentina 126
Green Growth 128
A Look Ahead: Cannes, France, November 3-4, 2011 129
Acronyms and Abbreviations 130

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Introduction

As the European sovereign debt crisis continues to deepen and the global economic recovery becomes more fragile, many meetings were held in September to try to come up with a solution. At the beginning of the month, the G7 finance ministers and central bank governors met in Marseille, France, where they initiated the long-term Deauville Partnership to support the historic changes under way in some countries in the Middle East and North Africa politically and economically. Although most of the discussions centred on the European sovereign debt crisis, they gave few specifics on how to solve it but pledged a continued coordinated international response.

There was a heightened sense of urgency when the G20 finance ministers and central bank governors met on September 22 in Washington DC. They stated that they are taking strong actions to maintain financial stability, restore confidence and support growth. Eurozone countries have taken significant steps to ensure the sustainability of public finances and are implementing the decisions taken by European leaders on July 21, 2011. By their next meeting in October, the eurozone will have implemented the necessary actions to increase the flexibility of the European Financial Stability Facility (EFSF) and to maximize its impact in order to address contagion. The United States has put forward a significant package to strengthen growth and employment through public investments, tax incentives and targeted jobs measures, combined with fiscal reforms to restore fiscal sustainability over the medium term. Japan is implementing substantial fiscal measures for reconstruction from the March 2011 disaster while ensuring the commitment to medium-term fiscal consolidation. Heightened downside risks have also made the economic environment for emerging markets and developing economies more challenging and they are adjusting their macroeconomic policies accordingly to maintain stability and sustain growth.[1] Although the finance ministers and central bank governors discussed the different initiatives undertaken, they once again failed to discuss a specific mechanism to either leverage or expand the bailout fund.

During the annual fall meetings of the International Monetary Fund (IMF) and the World Bank on September 22-25 in Washington, the finance ministers from Brazil, Russia, India, China and South Africa (BRICS) issued a communiqué. They stated that while the BRICS countries had recovered quickly from the 2008-09 global financial crisis, some have been subject to inflationary pressures, and growth prospects of all five countries have been dampened by global market instability. In advanced countries, the build-up of sovereign debt and concerns over medium- to long-term plans of fiscal adjustment are creating an uncertain environment for global growth. Also, excessive liquidity from aggressive policies taken by central banks to stabilize their domestic economies has been spilling over into emerging market economies, fostering excessive volatility in capital flows and commodity prices. BRICS countries are taking necessary steps to secure economic growth, maintain financial stability and contain inflation. They are also determined to speed up structural reform to sustain strong growth to advance development and poverty reduction and to benefit global growth and rebalancing. The contribution of BRICS countries and other emerging market economies to global growth will continue to increase. However, global rebalancing will take time and its impact may not be felt sufficiently in the short term. The BRICS ministers also pledged to intensify trade and investment flows among their countries to build upon their synergies.[2]

A tumultuous month in Europe saw European Commission president José Manuel Barroso announce that he would propose options for euro bonds, which face opposition from Germany among other member states. Austerity measures were passed in Italy and France, and faced continued resistance in Greece, where the markets suggested a default may be inevitable and fears of a slip back into recession have increased. China said it was willing to buy euro bonds from countries in the sover-

1 G20 Finance Ministers and Central Bank Governors (2011), "Communiqué of Finance Ministers and Central Bank Governors of the G20," September 23. <www.g20.utoronto.ca/2011/2011-finance-110922-en.html>.

2 BRICS Finance Ministers (2011), "BRICS Finance Ministers' Joint Communiqué Issued at the end of Meeting in Washington," September 22. <www.brics.utoronto.ca/docs/110922-finance.html>.

eign debt crisis and, in a reversal of fortune, Brazil said it would support a viable framework for a rescue package. The Bank of England, the U.S. Federal Reserve, the European Central Bank (ECB), Bank of Japan (Bank of Japan) and Swiss National Bank (SNB) came together in a coordinated intervention to provide additional liquidity to commercial banks with recently hard-to-find dollars due to fears of a Greek default. Moody's downgraded eight Greek banks due to their exposure to Greek sovereign debt and the deteriorating economic situation in the country. It also downgraded France's Crédit Agricole SA and Société Générale and put BNP Paribas on review. Standard and Poor's (S&P) downgraded Italian banks Intesa Sanpaolo and Mediobanca along with Italian government debt. The overarching problem is that banks and sovereigns are holding much more potentially bad sovereign debt than they did when governments provided funding at the height of the financial crisis in 2008. Governments today would not have the capacity to provide the guarantees necessary on such a large scale. IMF funding levels have also been pushed to the brink. There is enough capital to fulfill its current obligations but if the crisis widens and deepens, the IMF will not have the funding to assist as it has in the past. EU member states began to ratify the July 21 initiative to expand the EFSF bail-out fund and by month's end, the majority of member parliaments had passed it. Italy and France extended their bans on short selling financial shares until November 11, 2011, while Spain extended its ban until market conditions warrant otherwise.

U.S. president Barack Obama presented his $477 billion *American Jobs Act* to Congress on September 12 and repeatedly urged Congress to "pass this bill now." The bill would mostly be funded by limiting tax exemptions and deductions for families earning more than $250,000 and individuals earning more than $200,000, closing tax loopholes for oil and gas companies, and changing taxes on corporate jets and interest earned by fund managers. The Republicans refused to support an increase in taxes for job creators. Warren Buffet supported the increase in taxes by saying that millionaires should not pay less tax than middle-income earners. At month's end, talks had stalled. One major provision buried in the act increases the tax on sales of investment management partnerships to the ordinary income tax rate of 35% rather than the current 15% capital gains rate. Investment management firms would be the only businesses in the U.S. to be taxed at ordinary income tax rates if this enterprise value tax proposal becomes law. Further political posturing threatened the debt ceiling for the third time this year. Senators reached a compromise on disaster relief spending that would keep the government running until November 18. After Hurricane Irene ravaged the northeast, the Federal Emergency Management Agency (FEMA) needed more funding. Complicating the request was that fiscal year end was September 30 and Republicans would not agree to raise the current budget for disaster relief without accompanying tax cuts. FEMA said it could work with its current funds until the end of the month (which was only a week away). The longer term funding would be discussed at the beginning of October. Moody's downgraded Bank of America due to its concerns that the U.S. government would not provide a bail out if it ran into trouble. It also downgraded Citigroup and Wells Fargo.

Russian prime minister Vladimir Putin announced that he will run for the presidency next year after current president Dmitry Medvedev stated that he would not seek another term. In an unprecedented move, finance minister Alexei Kudrin resigned, saying that he could not work under Medvedev as prime minister. Kudrin has cut Russia's debt to 10% of gross domestic product (GDP), which helped it weather the current financial crisis.

Swiss bank UBS AG has suffered losses of more than $2.3 billion because of a rogue trader who has been charged with fraud by abuse of position and false accounting. Although the bank stated that no client positions were affected because trader Kweku Adoboli was a director on the Delta One derivatives desk, CEO Oswald Grübel resigned in order to take responsibility for the incident. Sergio Ermotti has taken over on an interim basis. Moody's and S&P have both put UBS on review for downgrade.

In its economic assessment, the Organisation for Economic Co-operation and Development (OECD) conceded that a global economic slowdown is under way and that governments should stimulate their economies and curtail their debt as the economic recovery has come to a halt. The IMF's *World Economic Outlook* stated that the global

economy is in a dangerous phase. The forecast for advanced economies is a continuing, but weak and bumpy expansion. Prospects for emerging market economies have become more uncertain again, although growth is expected to remain fairly robust.

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