Strong Financial Systems - The OECD Approach and Its Relevance for Emerging Markets

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Distinctive OECD Approach

- The OECD does not make long-term loans, or investments, provide long-term on-site technical assistance or impose conditionality.
- Our advice is relatively informal and is transmitted by a process of “policy dialogue” that is similar to OECD Committee process.
- This method is well suited to the subject matter of financial sector reform where there are no simple answers.

Develop a “Community of Policy Practice”

- The result of a group engaging in policy dialogue over time
- a shared vocabulary and an accumulation of shared experiences - of what has worked well and what hasn’t in various circumstances
- Each participating policy-maker has the responsibility to apply these experiences as a guide for action in their own environment.

Two overriding goals of the governance systems of banks:

- to achieve adequate rates of return
- to observe high standards of prudential soundness

Authorities should assure that banks observe prudential standards and have adequate risk management systems.

The bank supervision agency requires independence and institutional strength

- Bank surveillance should be exercised <u>solely</u> in the interest of prudential soundness.
- The development of adequate capacity to engage in market-based supervision should be a high priority in financial reform.

Bank Supervision and Risk Management

- Supervision should be <u>multi-tiered</u>, with banks' internal risk management and credit systems serving as the first line of defence and with the market exercising discipline.
- The primary task of the authorities is to assure that market-based surveillance is working properly.

A regime of limited deposit insurance underpins confidence in banking and limits moral hazard.

- Important to delineate in a financial system those activities for which the authorities provide guarantees and those where market participants bear the risk.
- Limited deposit insurance also allows the market to assess and price credit risk.

Bank Ownership Issues

- The ownership structure in banks has a strong impact on the quality of governance.
- Two issues:

1) Government ownership

2) Banks that are part of family-owned industrial-financial conglomerates

Swift Action to Resolve Troubled Institutions in Bank Crisis

- Realistic assessment of the state of balance sheets
- Coherent strategy to resolve the non-performing loan problem
- Provision of sufficient public funds to restructure banks conditional upon adequate corrective action by the banks

Concluding Remarks

- Financial market reform is a complex and never-ending task.
- Markets are constantly changing due to innovations, new technologies, the dynamic processes of globalisation and market integration.
- Our objective should be to develop financial systems and foster market discipline that will be robust to such changes and unexpected shocks.