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Private Sector Views on Financial Stability

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Let me give you some views from the private sector. First, I will share a thought from my institution and myself and then I would like to relay the main points that we have collectively agreed on in a large group of banks, the Institute of International Finance, with regard to private sector involvement in financial stability (and growth).

My first general point is that ING, as a large financial institution involved with the whole range of finance and a large number of individual clients, with lots of contacts, and with thousands if not hundreds of thousands of clients all over the world, is very aware of the deep unease so broadly felt about the development process, about globalisation, and specifically about the role of finance in globalisation. The concern is there, we do not deny it, and it is a real concern that is related to the dominant role that finance has played in globalisation as the most globalised of all the economic sectors.

With the benefit of hindsight, we see that the attention of the last ten years or so has been heavily focused on the cross-border elements of the internationalisation of the financial system. That is where we, the financial sector, have put our people, where we have put our assets, where we bought companies, and where we put our thinking power. It has been placed in promoting cross-border flows in the securities area, in corporate financing, in the bond area, in the equity markets, in the financing of trade. This was all wonderful business, and it was extremely profitable and exciting – for a while.

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But the situation has changed and, looking back, I think we have focused too much on cross-border flows. It has been overdone in the sense that we neglected to put enough focus on the primary necessity of strengthening domestic financial markets, domestic systems, and domestic institutions – for it own sake, and also as a necessary basis on which to base stable international flows.

We in the financial sector now see the necessity to focus on domestic financial systems in the broadest sense much more clearly than before: payment systems, transfer mechanisms of every type, institutional savings. At ING, we emphasise this broad sense, being an institution that is an integrated financial services institution, not a bank; we want to cover the whole range of financial instruments. This new view is rather deeply felt and it translates into clear changes in strategy of our institution and quite a number of other institutions, but it also leads to a diversion within the group of financial sector institutions.

Within the Institute of International Finance I see a divergence between the few strong big international players in cross-border flows, certainly in the capital market area – the investment banks in New York, who are usually very dominant in the international discussion – and us, the more integrated financial services organisations, located mainly in Europe. We have a broader range of interests and are not so much focused just on the international bond issues and the intermediation of international flows, we have a broader range. There is also a divergence because of the increasingly strong role of the holders of the assets, the bondholders: pension funds, insurance funds, and all of the various mutual funds. They are generally taking a much more independent view, independent especially from the investment banks.

What have we decided collectively within the Institute of International Finance? Even though the IIF is a group that ranges from the big Wall Street investment houses to the integrated financial service companies, the emerging markets banks and everybody else, we still reach pretty good consensus on the main lines. Interestingly, the first big point we all agree on is the necessity of domestic financial sector development. This is accepted by everybody as the main emphasis, because weak financial systems have been at the centre of broader economic crises in emerging markets too frequently.

The second point we agree on is that of technical arrangements to reduce risks, which includes three areas for action. The first area is the need to improve investor relations. It has been often emphasised by the private sector that there is a need to have a continuous exchange of views and information between the official sector and the whole range of private sector institutions, about government debt, the public finances, etc., so that the holders of bonds, the short-term, the long-term, the medium-term investors, all of the people in the private sector involved with putting up cross-border positions in a certain country, have access to the authority in a structured and organised way. That has generally been lacking in the past, now it is quickly improving. For instance, Mexico is doing a great job in this as are many other countries. It is a big point for us to emphasise the need for those investor relationships. Of course the same story goes for the transparency of macroeconomic and financial data and the dissemination of these data – which is a second area. A lot of progress has been made here, but it still remains a key point, closely related to the first.

The third area is the old idea of contingent credit lines to prevent financial crises. Unfortunately, it has not really worked very well. Countries considered it a sign of potential problems and weakness. There have been certain misgivings about contingent credit lines, both within the IMF and the private sector, but we think they again deserve attention as do public-private cooperation schemes. There are ways that risks can be shared that should not be forgotten.

Finally, I come to the third and key point of an orderly sovereign debt restructuring process. We see three lines of action.

First, strong emphasis should be placed on the consultative element. The lack of consultation with the IMF has always been a complaint of the private sector, partly as a result of the secrecy element of IMF consultation with member countries. This is already changing; there is a private sector contact group. It needs to be expanded, institutionalised and broadened because the range of financial products present in cross-border exposure is wide, much wider than in the 1980s. We need to work on a strong consultative process between the private financial sector and essentially the IMF.

The second line of action is the contractual element, which really means working on the collective action clauses. Much work has already been done, and most of us want this to happen; the large European and American borrowers need to get on board, we have to push that practical steps are advanced to include collective action clauses in bond and loans contracts.

The third line of action is a legal element, where we need to put some teeth into fighting those creditors who are against conforming to the majority. We need a targeted legal strategy to address vulture funds and limit disruptive litigation stemming from holdout creditors.