**GLOBALIZATION: THE ROLE OF INSTITUTION BUILDING IN THE FINANCIAL SECTOR – REPORT TO MINISTERS AND CENTRAL BANK GOVERNORS**

**DISCUSSION PAPER**

During the G20 Ministerial meeting in India in November 2002, several Ministers/Governors emphasized the central role of institution building in the functioning of markets and more generally in economic development. Against this background, G20 Deputies included in the agenda for 2003 the topic: "Globalization: The Role of Institution Building in the Financial Sector".

In addition to the guidance received from Ministers and Governors, in selecting this particular topic several elements were taken into consideration:

- While strong institutions are required in a range of areas, it was deemed appropriate to focus the issue of institution building within an area more in line with the expertise of G20 members.
- Deputies took into account that financial markets cannot function adequately in the absence of an appropriate institutional framework, and that this is especially the case in a situation of rapid globalization like the one we are witnessing today.
- It was also thought that the combination of different levels of development and an ample variety of experiences provided the G20 with a unique platform to analyze this issue. It was determined that a thorough discussion of the Group's experiences can help build a more solid ground for understanding the role played by institution building in developing the financial sector and more generally in fostering economic growth.

In this context, G20 members were invited to prepare case studies on their experience with institution building in the financial sector. Since there are a variety of views as to what the term "institutions" comprises, it was agreed to conceive them as "the rules, enforcement mechanisms, and organizations that shape the functioning of markets". Participants in this project included the following countries: Australia, Canada, Germany, India, Indonesia, Italy, Japan, Korea, Mexico, People's Republic of China, Saudi Arabia, the United Kingdom, and the United States. In addition, the European Central Bank and the International Monetary Fund prepared papers dealing with these issues from a European or cross-country perspective.

This note briefly discusses the main subjects addressed in these studies. The exercise is a complex one, since both the issues and the emphasis varied substantially from one paper to another. In fact, one of the main purposes of this note is to try to highlight the most important issues raised, with the objective of allowing in the future an in depth consideration of very specific topics. Thus, Deputies are seeking to receive guidance from Ministers and Governors on the following:

a) whether they would deem it useful to incorporate "Institution Building in the Financial Sector" as a part of a medium term agenda for the G20; and

b) if this were the case, which of the particular topics derived from the papers prepared should be included for discussion and under what order of priority.

Several papers emphasize that the unique experience of individual G20 Members with institution building in the financial sector cannot serve as a blueprint or detailed road map for the optimal pace and sequencing of institutional development in other countries. The institutional framework must be closely geared to country specific circumstances. Nevertheless, it is also noted that the consideration of other countries' experiences with institution building can offer important lessons for those economies seeking to construct an efficient and effective framework for the financial sector.

The papers prepared for this project cover a wide range of topics. For purposes of efficiency, this note concentrates only on those where the highest attention was drawn and those which may give rise to more debate and more useful lessons. In this context, the following subjects are considered:

- Benefits and Challenges Derived from Financial Deregulation and Liberalization.
- Has Financial Deregulation and Liberalization Contributed to Strengthening Institution Building?
- The Central Components of an Adequate Institutional Framework for the Financial Sector.
- The Role of International Financial Institutions.

**1. Benefits and Challenges Derived from Financial Deregulation and Liberalization**

In several countries the costs incurred because of financial repression highlighted the benefits of financial deregulation and liberalization. In these cases, direct controls of both interest rates and credit gave rise to the stagnation or even decline of savings and distorted the working of fundamental price signals, as volatile, negative real interest rates retarded development of a credit culture and appropriate risk management. Also, a system of excessive regulations restricted banks´ operational flexibility and their ability to compete, and stimulated riskier lending with the free portion of banks´ resources, thus raising costs and affecting the quality of bank assets. Furthermore, restricted bank financing to the private sector, coupled with low real interest rates for bank deposits, caused in some cases a considerable expansion of informal credit markets, which increased the potential for instability and complicated the implementation of monetary policy.

More generally, financial deregulation and liberalization was seen as a means to enhance the development of the financial system through several channels. Although it is difficult to isolate its effects from those of other policies implemented concomitantly, overall the papers that analyzed the impact of financial deregulation and liberalization report a positive influence on the development of the financial system. First, the increase in the breadth and depth of financial markets should lead to a reduction in transaction costs. Second, by expanding the pool of liquidity in markets, financial liberalization should provide greater scope for diversification and permit a more efficient pricing of risk. Third, financial deregulation and liberalization was also seen as a means to improve the allocation of financial savings, by removing barriers to the flow of savings into the highest yielding investments, by reducing interest rate margins through higher competition, and by fostering greater financial innovation to meet the needs of consumers of financial services. The increased competition brought about by liberalization and deregulation was seen as crucial in some cases. According to these views, in the long run there cannot be efficiency without competition, and without efficiency there cannot be stability in the banking and financial industry. Furthermore, the larger presence of foreign banks that resulted from financial liberalization contributed to the strengthening of the capital base of the banking sector, improved the efficiency of the financial system through their technology and risk management practices, and provided a demonstration effect on the rest of the financial system. In the case of the European Union, financial integration is helping to build efficient institutions and has had and is still having a measurable impact on the region's GDP growth.

Notwithstanding the positive impact of financial deregulation and liberalization on the development of the financial sector, some caveats have to be made. First, the positive influence of regulation under certain economic and social conditions is underlined in one case study. Second, several papers warn of the risks that might accompany efforts of this nature. In some cases, innovation in product design blurred the boundaries between financial instruments and institutions, thus giving rise to regulatory gaps. Also, in a deregulated environment, banks were able to lend to higher risk borrowers and also needed to take account of exchange and interest rate risks to a greater degree than before. As banks were on occasions slow to adjust risk assessment procedures to the new environment, this combination of factors gave rise to a deterioration of loan quality. The implications of inadequately supported financial deregulation and liberalization efforts are reported to have been serious in some countries. In particular, when financial deregulation and liberalization (especially the opening of the capital account) coincided with institutional weaknesses, such as an inadequate supervision of banks or inexperienced management at the helm of national institutions, the stage was set for a major financial crisis. For this reason, it is of utmost importance that before embarking on financial deregulation and liberalization a robust institutional framework is established.

**2. Has Financial Deregulation and Liberalization Contributed to Strengthening Institution Building?**

Several papers support the notion that financial deregulation and liberalization stimulated institution building. In fact, the positive impact of financial deregulation and liberalization on institution building has worked through several channels. In some cases, the challenges raised by financial deregulation and liberalization and other policies gave rise to a new wave of financial reforms aimed at addressing those institutional weaknesses that were made evident during the process of deregulation and liberalization. For instance, in some countries during these renewed efforts of reform the blanket coverage on bank deposits (which had given rise to moral hazard problems) was eliminated, barriers to foreign ownership of banks were relaxed, the framework for supervision was streamlined, the legal framework for bank lending was strengthened, and so on. Institution building was also stimulated as a result of the additional market scrutiny that came with deregulation and increasing integration with global markets, and of the transfer of knowledge from foreign financial institutions participating in the local market.

The case of the European Union is particularly useful to illustrate the stimulus that can be provided by financial integration to the process of institution building. EU countries have adopted an approach to regional integration with a strong institutional component. Thus, integration in this region has represented an external anchor that puts policy makers under continued pressure to promote better domestic institutions. Efforts have encompassed a number of layers: political, economic, legal, and regulatory. By defining a set of harmonized minimum requirements for all member states, while simultaneously enforcing mutual recognition of national practices, a learning process about best practices has been prompted, which has in turn generated momentum for continuous improvement of institutions. In striving for best practice, EU integration has speeded up the institutional reform process especially in the peripheral economies where financial development was initially lagging behind; in the same vein, EU enlargement is currently accelerating institutional reform in the acceding countries.

Of course, policies can and should influence the institutional structure of the financial sector directly, not only indirectly through liberalization, and it would be inappropriate to rely on deregulation alone to generate a stronger institutional structure. Rather, policies that encourage a strong institutional structure in key areas are likely a prerequisite for a successful deregulation experience.

## 3. The Central Components of an Adequate Institutional Framework for the Financial Sector

Overall, the papers contemplate a long list of institutional elements that are deemed important for a sound development of the financial sector. This section refers only to those that were seen as central in several of the papers. On occasions, divergent views were observed regarding the particular features of the institutional framework required in some of these areas.

### a) Monetary and Fiscal Policies

In analyzing the main characteristics of an adequate institutional framework for the financial sector, several papers emphasize the role of an appropriate institutional scheme for the implementation of monetary and fiscal policies.

Central bank independence is considered as a fundamental component of the institution building process. In particular, central bank independence is seen as a means to institutionalize the objective of price stability.  On this basis, the credibility of monetary policy serves to establish a stability culture, which renders important benefits in fostering “long-termism” and low interest rates. Some countries reported that the globalization of financial markets fostered central bank independence, as a result of factors such as a closer monitoring of the economy in international markets, or by resulting in the abandonment of non-market means of monetary control, many of which were in the hands of the Government rather than the central bank.

Given the fact that a prudent and efficient management of fiscal policy is a necessary condition for macroeconomic stability, several countries have introduced or are considering implementing a number of institutional adjustments aimed at contributing to achieve this objective on a long term basis. The nature of these efforts varies from one country to another. In some cases, it implied the development of a multiannual perspective for public finances consistent with debt sustainability in the medium term, the incorporation of automatic adjustors in the budget to help ensure that the approved expenditure ceilings and deficit targets are met, or the design of Fiscal Responsibility Laws. In other cases, the Government adopted an explicit strategy to maintain budget balance, on average, over the course of the economic cycle, or set as an objective to keep public sector net debt as a proportion of GDP at a stable and prudent level over the economic cycle. The fiscal rules agreed by the EU countries provide an additional example of the importance attached by some countries to the institutionalization of sound public finances.

Some countries have been especially concerned about the possibility of policy coordination failures among the institutions in charge of fiscal, monetary, and supervisory responsibilities. In this context, special institutional mechanisms for coordination and communication among them have been designed to address this risk.

**b) Supervision of Financial Institutions and Markets**

There are divergent views on the appropriate institutional framework for bank supervision. At one end of the spectrum, some countries have allocated broad supervisory powers to the central bank, and there are even cases in which laws have been recently promulgated to expand the central bank's role in other important sectors of the financial market. On the other hand, there is a growing number of countries where banking supervision has been separated from the operation of monetary policy. Several studies report on the creation of a single regulatory authority entrusted with broad supervisory powers for the banking and insurance sectors, pension funds, as well as the securities market. Some stress that a framework has been established within which the regulator is independent from the Government in the pursuit of its statutory objectives, and note that international standards recommend the establishment of independent regulatory authorities.

It is difficult to conclude ex ante whether one of these options (or an intermediate one) is superior to the other, since there are a number of arguments in favor and against each of them. Supporters of a unified institutional structure for supervision underline the potential for economies of scale, its simplicity, the fact that the traditional functional divisions are no longer so relevant taking into account developments in the financial sector (e.g. emergence of financial conglomerates), the prevention of regulatory arbitrage, improved accountability, reduced costs, and better policy coordination. On the other hand, such a structure is criticized on the grounds of the remaining differences that persist between banks, securities firms, and insurance companies. Other limitations attributed to a unified regulator include its organizational complexity, and the risk of creating an excessively powerful agency.

The papers raise two other issues in the field of financial supervision that deserve to be noted:

- The importance of an independent supervisory authority. Some papers conclude that in cases where the supervisory authority does not have full independence, mechanisms for actual enforcement of remedial measures against weak banks have limited effectiveness, notwithstanding the existence of relevant provisions in regulations.
- Globalization has important implications for financial regulation and supervision. Some papers note that globalization has been accompanied by a number of structural changes, including the consolidation of banks, intensified competition, internationalization of financial activities, and the establishment of mixed financial groups and conglomerates. Thus, financial regulators and supervisors have been confronted with a rapidly evolving environment and a number of challenges. The latter include the need to update regulations to keep pace with financial market developments, and to strengthen cross-border cooperation in the areas of prudential supervision, financial stability, and crisis management.

A common concern raised in the papers with regard to deposit insurance relates to the need to avoid the moral hazard that may be linked to this type of institutions. The consensus view is that, to avoid moral hazard, deposit insurance must not rely on comprehensive government guarantees. The role of risk-adjusted deposit insurance premiums and of the principle of system beneficiaries contributing to the insurance fund are also stressed in this respect. In addition, some countries emphasize that the authorities must encourage banks to identify and master financial crises as far as possible by their own means. In this context, one country reports that its central bank does not even assume any precommitted lender of last resort function in order to avoid moral hazard. Thus, any direct involvement in addressing a financial crisis is decided on an ad hoc basis, reflecting an attitude of “constructive ambiguity”. In smaller banking systems, with a handful of banks, such a strategy could be less credible. This calls for strong supervisory safeguards to help contain any liquidity problems as early as possible.

On the other hand, it is important to note that two different views are observed in the papers regarding the role played by deposit insurance schemes during a period leading to an economic crisis. In one country, the existence of an unlimited backing of banking liabilities was seen as a source of moral hazard that contributed to an excessive expansion of bank liabilities. In this context, after the crisis erupted, the decision was taken to lift in a gradual and orderly way the blanket coverage of bank deposits. In other cases, to restore public confidence and to avoid bank runs during the emergence of the crisis, it was decided to introduce a full blanket guarantee of bank deposits. However, it must be stressed that even in the latter cases either a deposit insurance institution with limited guarantee coverage was established once the crisis was overcome, or this represents an objective of the authorities for the long term.

### c) The Strengthening of Domestic Capital Markets

The development of viable domestic capital markets which enable borrowers (both private and public) to fund themselves in their local currency and in longer-term maturities is fundamental for a sound economic development. Well developed domestic capital markets could potentially insulate the economy from some of the effects of global financial shocks by providing them with more stable and secure sources of liquidity. The ability to borrow in domestic currency may also be an important factor in assisting a smooth transition to a liberalized financial sector.

All the papers touching upon this issue report a fundamental role of the central bank, in cooperation with the Ministry of Finance and other public agencies, in fostering an active domestic money market. The primary emphasis in the early stages of this process has been on the development of a Treasury bill market, to an important extent as a means to place the central bank in a better position to conduct monetary policy. Some countries also report a positive influence of globalization on the domestic debt market. Interest rate deregulation required the existence of a risk-free yield curve in the government securities market, and a vibrant money market able to transmit the monetary impulses emanating from the central bank. Notwithstanding the emphasis put on facilitating the implementation of monetary policy, the establishment of a money market has also been seen as a means to foster better markets for other securities and to channel funds where they are most needed.

Several technical measures have been adopted to support the development of a local debt market. These include the following: more frequent auctions of Treasury bills and a gradual increase in the amounts issued; granting permission to banks and brokerage houses to submit bids at public auctions for Treasury bills; the development of a book entry system for securities and of a securities lending program; the appointment of “primary dealers” or “market makers” to enhance the liquidity of fixed rate securities in secondary markets by making continuous bid-ask offers in exchange for certain privileges; the permission to foreign institutional investors to invest in domestic securities; and the development of local institutional investors, such as pension and mutual funds.

In general, the development of an efficient Treasury bill market stimulated the expansion of an active market for corporate debt paper and led to the introduction of new products. Nevertheless, several countries, including some advanced ones consider that there is substantial room for development of the corporate debt market. Furthermore, collateralized securities issued by banks are referred to as instruments that improve the term structure of the bond market.

Several studies point to the necessity of strengthening the equity market as an important part of the domestic capital market in order to meet the financing requirements of the economy. Streamlining the regulatory framework, enhancing market transparency and the protection of investors, increasing access to foreign capital, and reducing operational costs, are among the policies deemed as important to strengthen domestic equity markets.

**d) Payment Systems**

The case studies identify the revamping of the operational and regulatory framework of payment systems as an important part of the institutional development of the financial sector. Several case studies refer to the responsibility of the central bank in promoting stability and efficiency in the payment system. Furthermore, some highlight that institutional developments in payment systems have been market-led rather than driven by legislative or policy changes.

Globalization and integration of markets and the concurrent growth in private capital flows, have led country authorities to review their payment systems. The aim has been to enhance the operational efficiency, reliability, speed, and timeliness of payment transactions, while reducing or containing financial and most notably systemic risks. In addition, there has been a desire to ensure that the speed and reliability of payment systems keep pace with the effective demand for payment services by financial market participants. Rapid progress toward indirect monetary policy, financial deregulation and liberalization, and currency convertibility have often been forces behind concomitant reforms in payment system policies and operations.

The information provided by standards assessments carried out by international institutions in the area of payment systems point to a high degree of observance in advanced economies. In developing countries, however, many payment systems have various design and operational limitations that expose them to more important risks and that often also imply efficiency shortcomings.

**e) The Legal Framework**

Legal certainty is an important precondition for the proper functioning of a market economy. This requires, first, legal concepts and instruments that are closely geared to the practical needs of economic agents, and second, effective procedures for enforcement.

Although the case studies refer to many elements of the legal framework for the financial sector, the role of reliable collateral and insolvency legislation is identified in some of the papers as a key requirement for market efficiency in this sector. A standard method of containing credit risk (and thereby reducing the cost of capital) is the demand for collateral from the borrower. Providing collateral is generally even a condition *sine qua non* for gaining access to long term bank borrowing. No collateral framework is, however, of any use without efficient enforcement rules in the event of insolvency. The importance of appropriate bankruptcy and secured lending legislation is underlined by the experience of one country, in which the absence of an appropriate legal framework in this regard has been deemed as a major obstacle for the resumption of bank lending to the private sector several years after having experienced a banking crisis. The role of bankruptcy legislation in establishing a market based system for the closure of non viable financial institutions is also noted in some of the papers.

### f) The Role of Technology

Several papers point to the fact that operating in a globalized environment requires a high level of technological development. Thus, information and communication technologies are considered a fundamental element in strengthening institution building in the financial sector. In one of the case studies, it is even concluded that the failure to adapt to the revolutionary progress observed in information and communication technology was a major cause behind the emergence of an economic crisis. Among the considerations for adopting new technologies, the papers include the following: that they operate reliably and are fully developed and tested; that they permit future enhancement to a level consistent with the most up to date procedures; and that they are compatible with the prevailing practices. It is also worth noting that technological developments are not free of risks. For instance, some papers stress that the swift development of on line financial services poses important challenges for both monetary policy and financial supervision. Thus, regulators must keep adequate track of technological developments and their implications for financial supervision and the implementation of monetary policy.

## 4. The Role of International Financial Institutions

The important role played by international financial institutions in developing the institutional framework for the financial sector, and specifically that corresponding to recommendations emanating from the Financial Sector Assessment Program (FSAP), is underlined in several papers. Overall, the work carried under the FSAPs was considered to be of high quality, and to provide an objective and rigorous evaluation of financial systems. Standards assessments completed in the context of FSAPs have been most useful in identifying gaps and prioritizing institutional reforms. By setting the diagnosis in a broader macroprudential context, the assessments also helped authorities to sequence institutional reform. Discussions within the FSAP context allowed the authorities a useful exchange of views, and self assessments performed as background for the FSAP compelled them to review the strengths and weaknesses of the financial system and its institutions on the basis of an international point of reference. In many instances, the FSAP provided an impetus to the authorities' reform efforts and helped to sharpen or redirect the focus of reform.

On the other hand, some of the papers note that FSAPs are not free of problems. First, standards and codes assessments carried out as part of FSAPs may not be consistent with some countries' stage of development. Thus, country involvement in the design and implementation of standards and codes remains crucial. In addition to ensuring that standards and codes are implemented taking into consideration local practices and infrastructure, this may allow the authorities to make an adequate diagnosis of the problems faced in one particular sector before the FSAP exercise is carried out.  Second, to be useful in the medium and long term, FSAPs need to be updated frequently. However, capacity constraints make this unlikely to happen. Third, implementing the recommendations emanating from FSAPs require in many cases appropriate technical assistance, but the resources available for this purpose are scarce. Fourth, especially since reports are updated infrequently and in some cases not even published, markets are not yet taking fully into consideration the evaluations made by the IMF and the World Bank under FSAPs.

## 5. Summary of Issues Identified by Case Studies

a) The evidence included in the papers prepared for this project support the notion that financial deregulation and liberalization can have an important beneficial impact on both the size of the financial system and its allocative efficiency. Nevertheless, several of them warn that financial deregulation and liberalization is also accompanied by risks. For this reason, it is fundamental to ensure that the necessary preconditions, including the required institutional setting, are in place before embarking upon a move in this direction.

b) Giving the interrelations between policies in different areas, it is important to take into consideration possible synergies of financial system reforms with other policies at an early stage. Moreover, institution building in the financial sector is not a singular event, but an ongoing process that must be constantly adapted to keep pace with market developments.

c) Financial deregulation and liberalization can represent a major stimulus for the development of appropriate institutions. In some cases, the challenges raised by financial deregulation and liberalization gave rise to a new wave of reforms aimed at overcoming the institutional deficiencies. In others, deregulation resulted in additional market scrutiny that stimulated institution building. As shown by the experience of the European Union, defining a set of harmonized minimum requirements applicable to all members can stimulate institution building especially in those economies at relatively lower levels of development.

d) Central bank independence, the development of mechanisms aimed at fostering sound public finances on a long-term basis, and appropriate schemes for the coordination of the authorities overseeing monetary, fiscal, and supervisory functions, represent fundamental elements of an adequate institutional setting for the financial sector.

e) The evidence available in the case studies does not provide a definitive conclusion on the appropriate institutional framework for supervision of financial institutions and markets. Nevertheless, several issues are highlighted that deserve further consideration, including: the merits of granting broad supervisory powers to the central bank vis-a-vis an approach in which the operation of monetary policy and banking supervision are separated; the creation of a single agency in charge of financial supervision; the importance of an independent supervisory authority; and the need to update regulations to keep pace with financial market developments, and to strengthen cross border cooperation in the areas of prudential supervision, financial stability and crisis management. It is also important to acknowledge the importance of the incentive structure provided by the mandate, accountability, and governance arrangements of the supervisory and deposit insurance agencies.

f) Regarding deposit insurance, a common feature of the papers is the concern of its potential impact on moral hazard. In this context, the importance of avoiding comprehensive government guarantees for deposits and to encourage banks to handle periods of crisis with their own means are underlined. On the other hand, a general loss of confidence in a banking system with limited deposit insurance may in fact increase the risk of market panic.

g) Payment systems represent a central part of the institutional framework of the financial sector. The development of payment systems is driven by a combination of forces, including involvement of the central bank, market stimulus, the desire to contain risk, the adoption of indirect instruments for monetary policy, etc. On the basis of the evidence collected through standards and codes assessments, it is observed that payment systems in many developing countries have various design and operational limitations that expose them to important risks.

h) Legal certainty is an important precondition for the proper functioning of a market economy. In this respect, several papers refer in particular to the role of reliable collateral and insolvency legislation for enhancing efficiency in the financial sector. The experience of the European Union, where this legislation has been built with a view to contributing to the integration and cost-efficiency of financial markets, as well as to the stability of the financial system, may be particularly useful in this regard.

i) Operating in a globalized environment requires a high level of technological development. Thus, appropriate information and communication technologies represent fundamental elements in strengthening institution building in the financial sector.

j) Economic development will be stimulated by viable domestic capital markets which enable borrowers (both private and public) to fund themselves in their local currency and in longer term maturities. Thus, the creation of the institutional infrastructure needed for the development or strengthening of domestic debt markets has central importance. In this context, special consideration should be given to the factors contributing to the expansion of the corporate debt market. Moreover, a strong equity market has an important role to play in improving the efficient allocation of resources and lowering the dependence on foreign-currency borrowing.

k) The IMF and the World Bank work on FSAPs has yielded useful results. G20 members are encouraged to undergo FSAPs, not only because of the benefits that accrue to each individually, but also because of the positive effects for global financial stability. On the other hand, every effort must be made to ensure that sufficient resources will be available to meet both the demand for FSAPs and the accompanying technical assistance needs, in order to foster ownership of the standards and codes assessments carried out under these exercises, and to promote market awareness of the value of the information provided by these programs.

l) Looking forward, prioritization of institution building in the financial sector varies substantially from one country to another. For instance, in reviewing the experience with FSAPs, the IMF notes that deficiencies among emerging markets in the area of financial regulation and supervision relate mainly to the ability of supervisory authorities to keep up with the proliferation of financial services, undertake risk based supervision, take prompt corrective action, deal with consolidated supervision, and cooperate with other domestic and foreign supervisory agencies. In the case of industrialized nations, the challenges in institution building relate mainly to the trend toward financial conglomerates, to electronic banking, to the role of state banks, to reinsurance, and to loan classification systems.

Notwithstanding these differences in emphasis, it may be useful to refer to some of the areas, beyond those raised in the previous pages, where the papers indicate that further action will be needed. The latter, which can also be taken into consideration in delineating the future agenda of the G20, include the following:

- Globalization requires greater international cooperation on financial sector regulatory issues.
- With globalization, the exchange of information and the cooperation between supervisory authorities and central banks should be enhanced, in particular with a view to macroprudential and structural monitoring of financial market developments, as well as in the area of crisis management.
- Globalization also calls for a strengthening of cross-sector cooperation in order to respond to the greater degree of integration of financial products, markets, and intermediaries.
- With globalization, large and complex financial institutions have emerged that raise risks for money and capital markets, and for the functioning of payment and settlement systems. Adequate monitoring of the financial risks incurred by such institutions is highly important from a systemic stability point of view.
- Limitations regarding preconditions for effective insurance supervision are widespread.
- The regulation and supervision of securities markets are also affected by a number of weaknesses in many countries.

**6. *Issues for discussion***

1. *Do you agree with the main issues derived from the G20 project on “Globalization: The Role of Institution Building in the Financial Sector”?*
2. *Should this topic be incorporated as a part of the medium-term agenda for the G20?*
3. *If this is the case, would the depth and usefulness of the discussions be enhanced by concentrating on very specific topics?*
4. *The papers prepared for this project have identified a number of particular issues related to institution building in the financial sector. Which of them should be included in the agenda for the G20 and under what order of priority? Are there other important topics that would deserve to be considered?*
5. *What specific actions could the G20 take to advance understanding and promote institution building? What would be the elements of a work plan to that end?*

**Responsible for this document: Mexico**