A FRAMEWORK FOR ASSESSING AND RESPONDING TO CROSS-BORDER FINANCIAL POSITIONS AND EXPOSURES

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1 **The bulk of cross border exposures are channelled through systemically-important global financial institutions and systemically-large financial markets and market infrastructure**. The current financial crisis, which is global in reach, has at its centre "top 50"-type global financial institutions as well as financial markets that have grown to be systemically large, such as credit derivatives.

2 **One of the tenets of effective surveillance is the balance to be struck among competing priorities: completeness of data, quality of analysis and burden that is placed on both reporting and collecting entities**. At the same time, it is important to bear in mind that cross-border capital flows are the lifeblood of capital-importing and capital-exporting economies, and such flows raise global economic growth potential. The objective is to better understand the impact of capital flows, not to impede them at all cost. Additionally, in drawing up criteria to identify institutions, markets and infrastructure that are important globally, it is useful to note that what is systemically-important domestically may not be systemically-important globally – and vice versa.

3 **Data gathering** can be enhanced in three ways:

a. To improve **frequency and quality of group-level data exchanged between home and host regulators**;

b. To analyse at the **global level aggregate risks undertaken by systemically-important global financial institutions**. Users may come to some agreement on a list of indicators that may be colleted by an international financial institution from systemically-important global financial institutions and for that international financial institution to make available an analysis of the largest aggregate risk exposures; and

c. To analyse at the **global level risks residing in systemically-large financial markets**. These include risks posed by systemically-important counterparties, one-way market positioning and liquidity risk. The same international financial institution could collect relevant indicators through central market infrastructure like exchanges, clearinghouses and settlement systems, and to make available an analysis of where risks or shocks may be forming. Where central infrastructure does not exist, some effort should be put on novating such contracts to an exchange or clearinghouse, such as credit derivatives.

4 **Home-host supervisory indicators should focus on proprietary risks borne by individual institutions, whereas the global macro indicators should focus on aggregate numbers and system-wide risks**. The separate assessments of global aggregate risks posed collectively to the systemically-important financial institutions and risks embedded in financial markets would serve as a cross-check on each other. A common risk identified on both sides would reinforce the signal on where a potential shock may emerge from.

5 **For any framework for global monitoring of aggregate cross-border risks to be effective, there needs to be a feedback loop to the institutional level such that policy analysis and action can be taken through the home supervisors on the institutions that bear the risks**. Global aggregate indicators and financial markets can indicate where risks are excessive or mispriced. However, risks are ultimately carried on the balance sheets of financial institutions.

6 The diagram below illustrates one such monitoring framework: