



HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

7 January 2009

Dear G20 Colleagues

UK OBJECTIVES FOR THE G20 IN 2009

The November 2008 meeting of G20 Leaders and Finance Ministers in Washington brought together advanced and emerging economies to determine how to address the global financial and economic and financial crisis affecting us all. Leaders agreed that urgent action was needed to make significant progress on the macroeconomic, regulatory and institutional reform agendas. As we head towards the next Summit on 2 April work is already underway by our officials who are working closely with experts and representatives of the relevant international institutions.

Gordon Brown will be writing to fellow leaders shortly setting out the main themes for the Summit. Given the ongoing turmoil in the world's financial markets and the related macroeconomic challenges that we now all face, I am writing now to emphasise the need for us to particularly focus our efforts on reinforcing international cooperation in the areas of financial market regulation and supervision.

I am very keen that we make real progress on these particular issues for the deputies meeting at the end of January so that proposals are sufficiently developed to inform our Ministerial ahead of the Summit, which I intend to hold on 14 March.

All members of the G20 have recognised that the financial system has failed in a number of key respects. Financial markets have been in turmoil globally, in some cases ceasing to function. Individual financial institutions have failed across the world. Other institutions have needed to turn to taxpayers to guarantee their liabilities, to provide liquidity and capital.

More importantly, the ability of the financial system to perform its critical role in the economy – allocating capital, managing risk and facilitating transactions – has been badly undermined. Ultimately, markets are no more than a collection of people and confidence in the system is a prerequisite for the operation of



financial markets.

Our first objective should therefore be to return trust and confidence to financial markets.

There have been failures of the regulated (financial services institutions) and of regulation. We need tougher global financial regulation. Our aim for the G20 in 2009 will be to work with international partners to address these failures and create a more robust financial architecture for the future.

The financial system should fulfil a vital role in the economy. Open, innovative financial markets are critical in driving forward economic growth. The financial system delivers capital – the life-blood of economic growth - to the real economy and no other better system has been developed than financial markets for allocating capital or managing risk. **Our second objective, therefore must be to retain and build on the benefits that open financial markets bring to the world economy.**

The key to retaining faith in financial markets is to establish and maintain a consensus within the G20 and elsewhere as to the importance of open capital markets. We need to have a fuller explanation of the benefits of the financial system, and of financial globalisation in particular. We need to be clear about the role that financial markets will play in tackling some of the other major challenges facing the world: climate change; the retiree boom; and investment in developing countries.

But although the focus must be on reforms that will work within the market-based system, that is not a reason for accepting the status quo. As there are specific failings that have been identified as a result of recent events we must come up with specific solutions. **Our third objective must be to reduce the likelihood of systemic failures in the financial services industry.**

We need improved governance of financial institutions. We should press for more active, informed and capable boards. We must demand better due diligence and care of clients' interests. And we must expect improved ethics.

We must ensure that the scope and reach of regulation is appropriate making sure that offshore jurisdictions do not permit firms to behave in ways that jeopardise financial stability. Firms must not engage in regulatory avoidance that compromises the integrity of the regulatory system. Prudential regulation should allow supervisors to prevent firms using business models or practices which increase systemic risk, even if they might be profitable for the firms themselves. It is important also to ensure that the financial system supports economic stability, including taking all necessary steps to address procyclicality.



There must be a step change in the way regulators work and, in particular, the way that national regulators cooperate. Information-sharing and cooperation on systemically important, cross-border firms through more effective colleges must become the norm. We need to make reforms to the Financial Stability Forum to make it more effective and representative. And we need to link macroeconomic and financial surveillance through closer collaboration between International Monetary Fund and FSF.

We must recognise that we neither could nor should operate in a zero failure regime. This is sensible recognition that regulation will never prevent all failures. **Our fourth objective should be to prepare better for failure within financial markets ensuring that we have the mechanisms in place to protect depositors; to ensure the orderly wind-up of failed institutions; and to make sure that there are the appropriate international mechanisms to coordinate the management of failed institutions.**

We also need better, more reliable arrangements to protect consumers when problems emerge including a more coordinated approach to compensation arrangements and firms themselves need to have robust contingency plans in place.

Reducing systemic risks and putting in place systems to address future failures carry inherent risks. For example, we have seen in the past the heavy-handed regulation can lead to sclerosis in financial markets where the ultimate losers are pensioners, savers and businesses in need of access to financial services. **Our fifth objective, therefore, should be to increase efficiency in the operation of financial markets, so that they perform the tasks of capital allocation, risk management and facilitating transactions more efficiently.**

I am sending this letter to all members of the G20, and copying to the Managing Director of the IMF and the President of the World Bank.

A handwritten signature in black ink, appearing to read 'Alistair Darling', with a long, wavy horizontal line extending to the right.

ALISTAIR DARLING