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FINANCIAL INDICATORS AND DATA COLLECTION EFFORTS: A REVISED PROPOSAL

Delegates to the Working Party No. 1 of the Economic Policy Committee and the Committee on Financial Markets are invited to provide written comments on this proposal and give their views on whether it forms an appropriate basis to take the work forward. To facilitate discussions among delegates, a dedicated electronic discussion group has been set-up on the following path: ECO/EPC/ECO & DAF Financial Market Indicators. The deadline for comments is 26 April. Provided that the proposal is viewed as broadly appropriate, the Secretariat will take comments received into accounts and send out a draft questionnaire on that basis by end May, to be amended as necessary at an experts meeting on 29 June.

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1. Introduction, background and key purpose

1. This paper refines the earlier proposal to develop a set of indicators of regulation of financial systems,[1] taking into account comments and suggestions received during the experts meeting held in September 2006. The structure of the proposed indicator system is provided, identifying the main institutional sectors and areas of regulation to be covered (section 2). On the basis of the proposed indicator system, the paper identifies the sub-components that could be assembled from already existing information and those that would be based on new information collected *via* a questionnaire (section 3). The proposal also gives a brief overview of how the set of indicators could be used for surveillance purposes (section 4). The remainder of this section provides the background to this proposal and gives and overview of the focus of the exercise.

1.1 Background

2. OECD surveillance of structural policies is based in part on the international benchmarking of both economic performance and policies. Such a benchmarking exercise underlies recommendations reported in the annual *Going for Growth* publication. So far, the set of quantitative indicators of policy cover essentially labour and product markets (along with some areas of education and health). Several member states have expressed the view that the financial sector is an important missing area in the structural surveillance exercise and have encouraged the Secretariat to extend the set of policy indicators to cover financial market policies.

3. In Autumn 2005, a paper prepared by the Secretariat on the impact of financial system regulation on economic growth was discussed by the relevant OECD bodies interested in the issue (EPC, WP1 and CMF). The purpose of the study was to make use of existing information to develop indicators of financial system performance and policy (especially competition-restraining regulation) with a view to identify areas of strengths and weaknesses, and eventually formulate country-specific policy recommendations.

4. In this regard, the Secretariat's paper was generally seen by Delegates as a good starting point. The main result from the empirical analysis, showing a significant negative impact of regulatory barriers to competition in banking, and weak regulatory requirements as regards investor and creditor protection, on value-added and productivity growth, was broadly accepted. However, there was a general view that further work was required before country-specific recommendations could be developed in this area. In particular, delegates felt that the set of indicators used in the empirical analysis was based on information about national regulations that was not sufficiently robust to permit the identification of relevant country-specific policy priorities in this area.

5. This paper refines an earlier proposal on how best to take forward the task of developing a set of indicators that is suitable for surveillance of OECD countries. The ultimate aim of the data collection exercise is to achieve better comparability and assessment of financial sector policies. Given the constraints of time and resources, the current paper proposes to confine data gathering to aspects of regulations that affect the long-term internal and external efficiency of the financial system, as regards

1. "Financial indicators and data collection efforts: A proposal", ECO/CPE/WP1(2006)10 and DAF/CMF(2006)31.

costs and allocation of assets, liabilities and risk. The outcome of such data collection effort will comprise an integrated database on regulation as well as a set of synthetic indicators derived from it.

1.2 The focus of the proposed exercise

6. In general, the main rationale for public policy intervention is to address a number of inherent market and information failures so as to ensure that resources are allocated most efficiently, with agents interacting in mutual trust. Some of these imperfections are common to most markets and are usually addressed with regulations aimed at preserving market integrity (conduct rules), protecting consumers (*e.g.* mandatory disclosure about products or services) and safeguarding competition (*e.g.* rules against collusion, excessive concentration and abuse of dominant position). Another purpose of government intervention which is more specific to financial markets arises from the presence of information asymmetry -- which implies that even with extensive disclosure rules, consumers/investors may not always be in a position to act in their best interests -- and systemic risk. To a large extent, these imperfections are addressed with prudential regulation which aims both at preserving financial stability and at providing additional protection for consumers/investors.

7. Hence, a comprehensive set of indicators of regulation could in principle cover a wide range of areas pertinent to the good functioning of financial systems. However, given the purpose of the current exercise it is suggested to focus essentially on those aspects of regulation that are seen as having a direct bearing on competition outcomes. One motivation for this is based on the findings from the Autumn 2005 study mentioned above.[2] In addition, various indicators point to sizeable differences across OECD countries in the degree of financial sector competition, suggesting that at least for a number of them further efficiency gains could be reaped from stronger competitive pressures, especially in retail markets.

8. Two broad types of regulation are of particular relevance in this context. Sector-based regulation affects competition within financial sectors, for instance by influencing the ease entry of new entities and/or the scope of activities that can be undertaken by specific financial intermediaries. Moreover, the strength of competition in the financial system as a whole is also underpinned by competition between different segments of the financial sector, *e.g.* competition in the mortgage market between deposit-taking institutions and other mortgage lenders who fund their activities in the securities market. The extent of competition between different segments depends in turn on whether the legal infrastructure provides adequate protection for creditors and investors. It is therefore suggested to concentrate efforts on these two categories of regulation. More specifically:

- This implies a fairly in-depth coverage of regulation directly and openly aimed at influencing the strength of competition in financial markets. The focus here will be on services with a strong retail component given that this is where further gains from stronger competition are most likely to be found.[3] In the cases where competition is not feasible, such as in the segments of financial systems characterised by important network externalities (*e.g.* payment systems), the coverage would include aspects of regulation put in place to ensure that the presence of natural monopolies

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2. The study has since been released as a working paper (de Serres *et al*., 2006). The results of this study are in line with recent work showing the impact that regulatory barriers to competition in specific sectors (network industries, retail distribution and professional services). See Conway *et al*. 2006.

3. The focus on retail activities is motivated by evidence suggesting that following past trends in deregulation and technological improvements, wholesale markets such as those for corporate bonds and large commercial loans have become much more integrated across national borders and competitive, at least in the OECD area.

does not hamper competition in other segments and that the monopoly part is operating efficiently.

- As regards regulation with other stated objectives such as consumer and investor protection, specific aspects of the relevant legal infrastructure (*e.g.* property, consumer protection and insolvency laws in the case of debt transactions and corporate law and securities regulation in the case of equity arrangements) will form part of the indicator system insofar as they are conducive to the efficiency of the financial system or, conversely, as they are viewed as unnecessarily hampering competition, notably by limiting the development of new financial products or services.

- Concerning the stability objective, the coverage of prudential regulation will be limited to those aspects that are viewed as potentially having a significant adverse effect on competition outcomes. As an illustration, information on capital adequacy (*e.g.* Basel II ratios) or prudential standards (*e.g.* adherence to IOSCO standards) *per se* would not be part of the indicators but aspects of such regulation which could be viewed as discriminatory *vis-à-vis* potential entrants in the market will be included.

9. The focus of data collection on regulation affecting competition outcomes does not imply any downplaying of the importance of fulfilling other regulatory objectives. The broad set of measures included in prudential regulation can all be motivated by the desire to minimise systemic risk and to preserve the soundness of financial systems. However, some of these measures (*e.g.* some entry requirements, restrictions on balance sheet and activity) may have unnecessarily adverse effects on competition and efficiency, insofar as alternative measures less detrimental to competition are in place to achieve the stability objective (*e.g.* disclosure, accounting practices, supervision, and risk-adjusted deposit insurance).

10. In any case, efforts are already underway in other institutions (notably the IMF and the World Bank) to construct databases on regulations that influence the stability of the financial system, and data collection in this area by the OECD would lead to duplication. As discussed below, in formulating policy recommendations for the financial sector, financial stability objectives would be taken into account, relying for this on databases assembled by other institutions. In order to do so, the set of indicators proposed below could be complemented with information on regulations deemed desirable from a stability objective, while having little detrimental effect on competition.[4] Such information would be drawn essentially from the *Bank Regulation and Supervision Database* (Barth, Caprio and Levine, 2004) and IMF country reports from the *Financial Sector Assessment Programme*.[5]

2. The structure of the proposed indicator system for financial system regulation

11. The overall system of indicators is divided in two broad categories. In one category, the information is structured around the main institutional sectors of the financial systems. The other category has the information organised around the key regulatory areas which together form the legal infrastructure that underpins transactions in debt and equity markets.

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4. An example of an index of regulation aimed at stability in banking is provided in Figure 3 of de Serres *et al*. (2006).

5. An up-date of the *Bank Regulation and Supervision Database* is expected in the course of 2007.

2.1 Coverage of sector-based regulation with a focus on barriers to competition

12. For sector-based regulation, the proposal is to focus on activities with a significant retail component. The coverage will therefore be limited to the key institutions involved in the provision of retail banking (current accounts, personal and mortgage loans, and lending to SMEs), long-term saving and collective investment services, as well as shares trading and post-trading services (Chart 1). These include essentially deposit-taking institutions, insurance companies, pension funds, collective investment schemes (*e.g*. mutual funds and unit investment trust), broker-dealers and stock exchanges, as well as systems for clearing and settlement.[6]

13. For each set of institutions, the indicator system will cover a number of common regulatory areas having an impact on competition, such as the competition framework and its application, ownership restrictions, legal barriers to entry of new entities or products and, where relevant, the set of rules governing the access to payment systems (Chart 2). An indicator of sector-specific, competition-restraining regulation would be constructed for each set of institutions and then aggregated to form an index of regulatory restrictiveness for the financial system as a whole.[7]

14. Although the generic set of indicators proposed in Chart 2 is meant to apply to each set of institutions listed in Chart 1, the coverage of specific items will vary to some extent. The coverage of deposit-taking institutions (banks and near-banks offering retail financial services) is likely to be the most comprehensive, given that for these institutions all four sub-groups of barriers to competition have relevance.

2.1.1. General competition rules

15. A key sub-component for the stance of general competition framework in each sector would measure how supportive general and/or sector-specific anti-trust rules are for competition. An important set of regulations on conduct of financial institutions is contained in the national *competition law* or in specific laws governing competition in financial services.[8] Aside from identifying specific exemptions from competition law, the areas covered will include the extent of rules prohibiting anti-competitive behaviour, along with enforcement mechanisms, such as the scope for aggrieved parties to seek redress and sanctions imposed.

16. The other key sub-indicator for the stance of the general competition framework in each of the sectors measures how the basic set of rules for *mergers and acquisitions* in different parts of the financial sector affects competition. Issues of interest in this area include the agencies involved in the review process, pre- and post-merger notification requirements, the criteria applied in M&A decisions in the financial sector and the independence of the final approval agency.

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6. Even though in principle mortgage lending that is funded by securities rather than deposits falls outside of these categories, it is nevertheless covered indirectly via specific aspects of the legal infrastructure that facilitate the development of securitisation (see below).

7. Given that the indicators will be constructed with a view to measure barriers to competition, the information will be quantified in a way that a higher value for each sub-component and the aggregate index can be interpreted as bad for competition.

8. Whether responsibilities for the financial institution sector in this area should fall under the competition authority or the financial regulator will not be considered but rather whether the framework is in place to ensure that the sector is subject to the same basic competition rules that apply to other sectors.

17. A merger or acquisition is also one way in which a foreign institution can enter the domestic market, with different implications for competition pressures as compared with a merger involving domestic entities. In this case, one risk is that the M&A rules are used in a discriminatory way against foreign institutions creating *de facto* a barrier to (foreign) entry. The proposed database would document the relevant barriers in this area, including issues related to the transparency and legal certainty. It would not collect information on non-regulatory types of barriers, such as differential tax treatments and supervisory requirements (multiple reporting).

2.1.2 State control and ownership restrictions

18. The indicator of state control in each set of institutions would be based on the extent of public ownership, state aid, the provision of state guarantees or direct controls over prices and conditions for certain products or services. All these interventions can potentially distort competition, especially if applied in a discriminatory way, either across domestic institutions or between domestic and foreign entities.

19. The implicit state guarantee that publicly-held institutions benefit from gives them an advantage over private competitors, at least in terms of financing conditions. In the case where the state is the sole owner, this advantage can even go further, given the lower pressures on managers to achieve strong profitability. *Public ownership* of financial institutions has declined during the 1980s and 1990s but remains significant in a few countries. In some cases, despite privatisation, the state has sought to keep control by maintaining a minimum ownership stake with special status (*e.g.* golden shares). Aside from collecting information on different forms of public ownership, the database would contain information about state guarantees.

20. Widespread controls of interest rates and insurance premia have largely been abandoned during the 1970s and 1980s in most OECD countries. However, regulation on fees and terms of specific products still prevails in several countries, either on equity grounds (ensure that poor households or students have access to basic banking services) or on efficiency grounds (preventing small firms from being excessively credit rationed), and these would be documented in the proposed database.[9]

21. Another area of regulation having a direct impact on competition concerns restrictions on the scope of activities that a single institution is allowed to perform across regions. Such geographic restrictions have been largely phased out in the past but to the extent they may still prevail in some countries, they would be covered under the state control sub-component.

22. Aside from price controls and public ownership, state intervention in the business operation of financial institutions can also take the form of favourable tax treatment for specific savings products (*e.g.* retirement, housing purchase or renovation). These are not considered as harmful for competition except when only certain institutions are allowed to offer the product on favourable terms, and the proposed database would contain information about this.

23. Finally, the indicator of restrictions on ownership of private financial institutions would be based on information about the maximum stake that a single owner can hold and on specific permissible types of

9. Whether or not the limited access for individuals or small firms to basic banking services (including credit) constitute a clear market failure justifying such controls is debatable but in any case, regulations should be implemented in a way that minimises potential distortions to competition (*e.g.* do the price controls on a specific product apply to all institutions providing the product? To what extent is the scope for cross-subsidisation which may vary across institutions taken into account?).

investors, in particular foreigners, but also other potential domestic investors, such as private equity groups.

2.1.3 Barriers to entry of new entities or new products

24. The indicator of barriers to entry of new entities in each sector covered would be based on information collected on licensing procedures, entry requirements, lines-of-business restrictions and barriers to exit.

25. Some entry regulation in the financial sector can be justified on the basis of concerns for the integrity of the financial system. Issues of interest in this area concern the regulatory impediments that look excessive or unnecessary in relation to the risks posed, or at requirements that appear particularly discriminatory against potential entrants. These include the extent of discriminatory minimum capital requirements for entrants and whether newcomers are required to be associated with other financial institutions. The application process for licenses could also be covered with a view to identify excessively lengthy and/or burdensome processes. Moreover, concerns with systemic risks should not lead to a situation where failing institutions are not allowed to exit, as this *de facto* restricts the scope for entry.

26. Restrictions on lines-of-business operations can also be considered as part of entry regulation and the main issues concern the extent of restrictions on the possibility for different types of financial institutions (commercial banks, investment banks, insurance companies, *etc.*) and non-financial corporations to offer different types of financial products. Such restrictions can be viewed as hampering competition, but whether or not safeguards are put in place to limit the scope of conflicts of interest (such as limits put on lending to related parties) would also be covered.

27. It is proposed to document to what extent companies in different sectors can engage in banking activities and under what conditions (*e.g.* integration with main activity, legal separation without or with consolidated supervision), but the information would be collected without strong priors as to whether restrictions in this area should be viewed as good or bad.[10]

28. Finally, various regulatory provisions which act as a barrier to the introduction of new products will be covered, including rules on placement and/or outright prohibitions of certain activities. For instance, various portfolio restrictions affecting major institutional investors can potentially limit the diversity of products offered to individual lenders and borrowers.[11] In some cases, restrictions are put on the ability of service providers to market products and services, especially across borders, and on the terms and conditions on various products. In other cases, regulation limits the scope for repackaging certain types of assets and for creating new instruments on the basis of these modified assets. Such aspects of legislation, which have their origin in provisions of property or consumer protection laws rather than sector-specific regulation, would nevertheless be captured under the *barriers to new products* sub-component.

10. One of the difficult issues related to entry into financial activities concerns the treatment of non-financial corporations wishing to offer specific banking services as a complement to their main line of business, which in some cases (*e.g.* supermarkets) already implies the presence of retail outlets. The main difficulty lies in preventing cases where genuine conflicts of interest between the banking and commercial functions arise without imposing excessive restrictions. One possibility would be to determine the type of activities to be allowed under a regulatory regime less constraining than that applying to formal deposit-taking institutions.

11. For example, portfolio restrictions for institutional investors may have repercussions on the development of a domestic venture capital market. However, regulations directly aimed at high-risk capital markets are not covered in the current proposal.

2.1.4 Access to payment systems and credit information

29. The indicator covering regulations influencing third-party ease of access to network activities in the financial sector would focus on payment systems (Box 1) and credit registries.

Box 1. Payment systems

From a competition point of view, the key feature of a payment system is its network dimension: the higher the number of agents sharing the same technical infrastructure the greater the benefits for individual users. Given these network externalities, it tends to function most efficiently as a near-monopoly, with a single settlement bank at its core. Once a system is well established, it is very difficult for a concurrent system to emerge. Even when different payment systems are in place, they tend to be complementary (*i.e.* they are usually specific to a particular means of payment) and rarely compete with each other. In part this is because the same institutions often control the different payment systems and have little incentives to foster competition (EC, 2006a).

The risk, however, is that access conditions to the payment infrastructure favours established institutions over potential entrants (especially non-banks), with adverse competition effects on non-network segments of the financial system, such as current account and payment-card related services for individuals and SMEs. Barriers to competition in this context may include:

- Governance arrangements which not only may create barriers to entry through membership rules and access fees but also may distort competition in the case where a full member can extract business-sensitive information from an associate member who happens to be a competitor in the retail market.
- Vertical integration of a specific payment infrastructure and its associated services. Such integration may not be always justified by economies of scope.
- Horizontal integration of different payment systems, *i.e.* the same institutions being members of the different payment systems specific for payment instruments (*e.g.* cards, direct credit or debit, cheques, etc.); by limiting the scope for competition between the various payment systems, this may reduce technological advances.
- Discriminatory (and inefficient) wholesale pricing practices (especially as regards interchange fees).

Of these, the first and the last are usually seen as potentially having the most significant impact on competition. The arrangements regarding interchange fees, *i.e.* the amount that the respective banks of agents (*i.e.* retail store owner and costumer) involved in a retail transaction charge each other for clearing and settling payment transfers, can be particularly relevant in the case of debit and credit cards payment networks (see EC, 2006b and OECD, 2006). Appropriate regulation may therefore be required to ensure an open access at similar conditions to all qualifying institutions, albeit with conditions being sufficiently demanding to minimise the risk of a major failure. For instance, members should be required to have high credit rating or adequate safeguards to face operational risks.

30. The information feeding into the indicators for payment systems would mostly focus on regulation of fees and conditions for third-party access, as well as on rules (if any) affecting ownership and governance arrangements, including the degree of influence of existing members on the decision to allow new membership.[12] Relevant aspects would also concern regulations for setting interchange fees in payment schemes and the conditions imposed on merchants allowing the use of specific cards as a means of payments in their retail store. The indicator on the access to credit databases would be based on similar

12. Earlier reports have suggested that while it is legitimate to restrict membership in the case of high value payment schemes to minimise large exposure risks, the case for restrictions is much less compelling for low-value transactions (Cruickshank Report, 2000).

elements and cover regulations concerning ownership and governance structures, type and coverage of data via private or public registries, as well as cost of access and rules regarding data protection.

2.2 Coverage of the legal infrastructure

31. The indicator of the legal infrastructure is intended to reflect the impact of statutory codes and arrangements on the efficiency and reliability of financial contracting, whether in the form of privately negotiated and highly personalised agreements or more standardised contracts (*e.g.* securities). It will document the degree of legal certainty in which the rights and obligations of the contracting parties are understandable and enforceable, including the impact of the legal framework on the cost and ease of contracting. As mentioned above, a number of legal arrangements, procedures and rules can foster competition in financial systems by facilitating the development of securities markets, and by allowing financial intermediaries to expand the range of innovative products and services.

32. The aggregate indicator will be based on three sub-indicators related to *i*) general contractual arrangements, *ii*) debt (or credit) arrangements and *iii*) equity arrangements (Chart 3). The basic legal infrastructure necessary to support each type of transaction is present in some form in all OECD countries.[13] It is therefore proposed to consider in each of these cases two broad aspects: the more general procedural efficiency of basic legal components alongside more specific, narrowly focused elements that affect the nature of competition in the provision of particular retail products and services.

2.2.1 General contractual arrangements

33. The indicator on general contractual arrangements will be based partly on provisions in contract laws, notably the framework within which contracting parties choose either to perform as required under the terms of the contract or to provide compensation as required for any “injuries” caused by their non-performance. More specifically, the elements covered under the *relevant provisions* component would focus on aspects of contract and consumer protection laws that are aimed at providing retail consumers of financial products and services with sufficient confidence that their rights will be fully protected. These include mandatory disclosure rules, government-mandated contract terms and provisions,[14] as well as restrictions on, or prohibitions against, self-dealing and certain other types of related-party transactions.[15]

34. One of the key issues in the area of contractual arrangement is enforcement, an aspect that would be captured under the *procedural efficiency* sub-component. More specifically, this would be documented on the basis of information about the procedural efficiency of the judicial system, the time efficiency of dispute resolution and the cost efficiency of court procedures.

2.2.2 Debt or credit arrangements

35. The protection of creditor rights, in particular the enforcement of property rights, is another important component of the indicator system of the legal infrastructure for financial services. Of particular

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13. In this case, given the emphasis on the strength of legal underpinnings, the information will be quantified in a way that a higher value for each sub-component and the aggregate index can be interpreted as good for financial market development.

14. For example, in the case of contingent claims, such as insurance policies, very detailed rules apply to the form and pricing structure of the contracts.

15. As indicated earlier, regulation aimed at consumer protection that is seen as adversely affecting competition by unduly constraining the provision of innovative products will be covered under the sub-component barriers to entry of new products discussed above.

relevance in the context of debt arrangements are the rules governing the creation, perfection, and enforcement of various forms of *"security interests"*. Hence, the sub-indicator on *relevant provisions* would in this case cover aspects of property law that affect the ability of parties to transfer, in whole or in part, financial interests, which is important to securitisation and other financial engineering efforts, and to liquefy interests in real property, such as through refinancing arrangements and home equity lending.[16]

36. The other key dimension of credit arrangements that would be covered under *relevant provisions* concern more directly the rights of creditors in the case of insolvency. In such circumstances, insolvency law generally enables financial institutions and other creditors to seek orderly resolution of the affairs of an insolvent/bankrupt concern. Of particular relevance in this context are the procedures for debt recovery, including the takeover or sale of assets that have been pledged as collateral. Insolvency rules may also distort competition, for instance if different institutions offering similar products face different levels of seniority on collateral claims. These aspects would be captured under a sub-index of legal rights of borrowers and lenders.[17]

37. In the case of debt or credit arrangements, the *procedural efficiency* sub-component would focus on the time- and cost-efficiency of bankruptcy procedures, including estimates of the recovery rate. Excessively lengthy or complex procedures may reduce the availability of loans, especially for higher-risk borrowers, as lenders would face difficulties in gaining access to and liquidating collateral in the event of problems. Whether a country favours a contractual or statutory approach to insolvency would not be considered *per se*.[18]

2.2.3 Equity arrangements

38. The indicator on equity arrangements will document the legal basis of corporate control and governance that influence the extent of investor rights *vis-à-vis* management and/or controlling owners. The sub-indicator of *relevant provisions* would in this case cover aspects of corporate laws and securities regulation that aim at strengthening the ownership role and rights of minority shareholders, dealing with conflicts of interests and underpinning the company oversights by boards. This will include, for instance, the ability of shareholders to cast their votes in various circumstances, but as well how effective the vote is in influencing decisions made by executive managers and the board. Also covered will be the mandate and role of external auditors.

39. Effective monitoring requires information and rules on disclosure to ensure that investors have access to the type of information they would need under reasonable circumstances to make informed

16. For example, in the case of mortgages, the variety of products (range of rates, terms and conditions) and services (*e.g.* equity withdrawal, early repayment facilities) related to retail lending can be facilitated by rules regarding collateral and/or by other regulations conducive to the development of asset-backed securities off-balance-sheet (such as the ability in many countries to sell or transfer loans without having to individually notify original borrowers).

17. Insofar as special procedures apply in the case of banks and other financial institutions, they would be covered separately under the *barriers to entry of new entities* discussed above.

18. Under contractual approaches to insolvency, the voluntary contractual agreements concluded by firms and various stakeholders remain valid in bankruptcy. Under statutory approaches, however, the prior arrangements may be abrogated in case of the firm's insolvency, in which case special statutes apply. The objective is the same – prevent the premature liquidation of viable firms, but facilitate a rapid process of liquidation or restructuring when necessary.

investment decisions.[19] Disclosure requirements will thus be covered as they constitute a central component of the regulatory approach to risks faced by investors in the case of direct investments in securities, such as equities and intermediated investments via collective investment schemes.

40. The other main components of investor protection regimes include anti-fraud provisions to ensure the information disclosed is accurate and some enforcement mechanisms. In this respect, the *procedural efficiency* sub-component will cover the extent of directors' liability and the ability of small shareholders to seek redress in the case of a self-dealing transaction.

3. Sources of information for the indicator system

41. The basic information required to construct the indicator of barriers to competition in each sector would for the most part be collected through a questionnaire sent to Member countries. However, in specific areas, the information will be drawn from existing data sources that are regularly up-dated (Chart 4). This includes various restrictions on portfolio and other investment as well as ownership concentration limits in pension funds and insurance, which will be based on the OECD Survey of Investment Regulations. The OECD database on FDI restrictions will also serve as a source of data for limits on foreign ownership and operations in the banking and insurance sectors, while some aspects of barriers to entry in banking will be drawn from the Bank Regulation and Supervision Database (Barth, Caprio and Levine, 2004)

42. In contrast, the construction of the set of indicators for the legal infrastructure will rely more heavily on existing sources of information (Chart 5). For instance, the three sub-indicators of *procedural efficiency* will be based on the World Bank *Doing Business* database. More specifically, in the case of general contractual arrangement and debt arrangement, it is proposed to use the *Doing Business* indicators of contract enforcement and efficiency of bankruptcy procedures, respectively. In the case of equity arrangements, the sub-components capturing the ex-post control of self-dealing from the investor protection index of *Doing Business* would be used as information for *procedural efficiency*.

43. As regard the sub-indicators of *relevant provisions*, the information would be drawn directly from the *OECD Corporate Governance and Company Law Database* in the case of equity arrangements, and in part from the index of legal rights of creditors from *Doing Business* in the case of debt arrangements. The remaining information would be collected from the questionnaire.

4. The use of indicators of financial market regulation in the broader surveillance exercise

44. As mentioned earlier, one of the key motivations for constructing indicators of financial system regulation is to integrate this area in the OECD surveillance exercise conducted in the context of the publication *Going for Growth*. The purpose of the exercise is to identify for each member states key policy priorities to lift GDP per capita on the basis of quantitative indicators of both performance and policies. Hence, the inclusion of indicators of financial system regulation in the *Going for Growth* exercise would allow for the selection of indicator-based policy priorities in this area for countries that are under-performing in terms of financial sector development or efficiency.

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19. Securities law establishes the legal framework within which financial instruments may be issued to the public and also governs the mechanisms by which securities on public offer may be traded, called, put, or retired. Measures to ensure market integrity also fall under the securities law envelope.

45. As an illustration, the indicator system would be used to identify potential policy priority in the financial sector in a country with comparatively weak productivity performance in the following stylised way:

- Various indicators of outcomes and policies would be used to detect potential weaknesses in the development or efficiency of the financial system as well as in the corresponding regulatory settings.

- If a weak financial development in a given country reflects low bank credit extension and the index of barriers to competition in banking suggests weaker-than-average competitive pressures, then this would be an indication that reforms stimulating competition in the banking sector could be a candidate for one of the selected policy priorities for the country in question.

- To further identify the particular policy weakness in this area, it would be examined if the sub-indicators for the overall indicator (*i.e.* general competition rules, ownership/governance, barriers to entry and access to network components) pointed to a specific weakness.

- If so, examining lower-level indicators for the particular problem area could point to a more focused potential policy priority.[20]

46. Even though the proposed system of indicators would contribute to identify specific areas of deficiencies in policy settings, judgement and local expertise would play an important role to ensure that policy dimensions that can not be captured adequately by quantitative indicators are nevertheless properly taken into account in the formulation of policy recommendations. For instance, in selecting a potential policy priority, it would be assessed whether such reform could have adverse impact on financial stability and/or consumer protection, which are only partially covered in the proposed set of indicators. If that were the case, the policy recommendation would include accompanying measures to offset the potential adverse effects of the proposed action. Furthermore, the use of policy indicators for structural surveillance requires information that is not only comparable across countries but also up-dated at regular frequencies. Efforts will thus be made that the set of indicators is based on information that can be up-dated regularly at reasonably low cost.

47. In addition to the general structural surveillance reported in *Going for Growth*, the outcomes of the exercise would directly contribute to the work underway in the Committee on Financial Markets and the Insurance and Private Pensions Committee on the efficiency of financial regulation. It would do so notably by helping to identify policy measures whose negative effects on competition and growth outweigh their benefits in terms of pursuing other objectives, as part of a more general cost-benefit analysis of financial sector regulation.

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20. If there were to be a large number of potential policy priorities for the country in question, the inclusion or not of this policy priority for the financial sector would depend on the selection procedures discussed in *Going for Growth* (2007).

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CHARTS

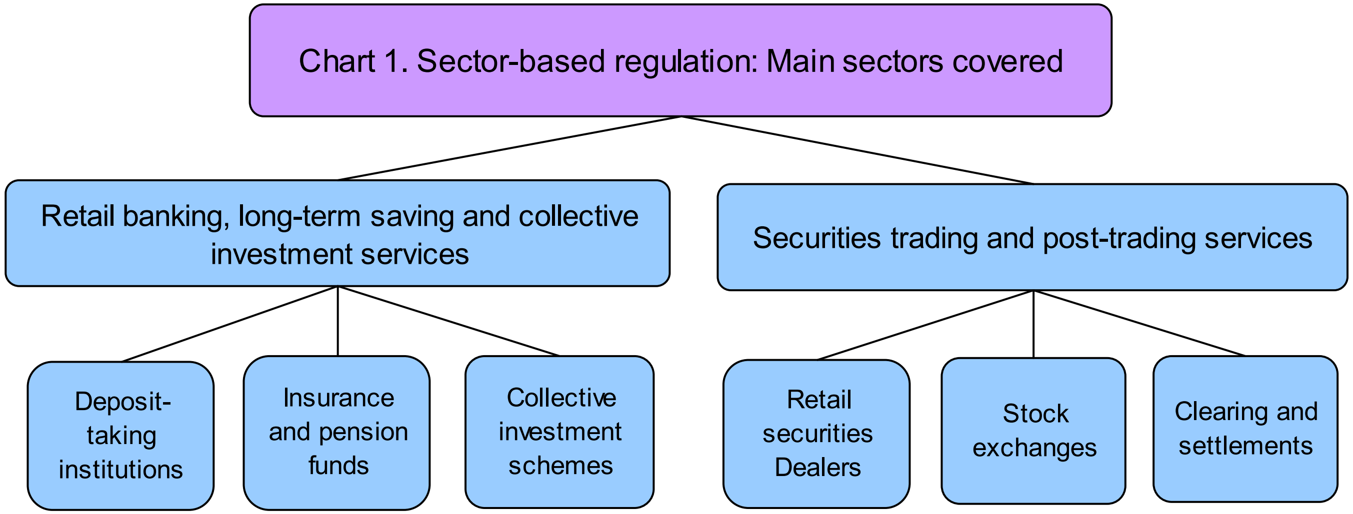
Chart 1. Sector-based regulation: Main sectors covered
Retail banking, long-term saving and collective investment services
Securities trading and post-trading services
Deposit-taking institutions
Insurance and pension funds
Collective investment schemes
Retail securities Dealers
Stock exchanges
Clearing and settlements

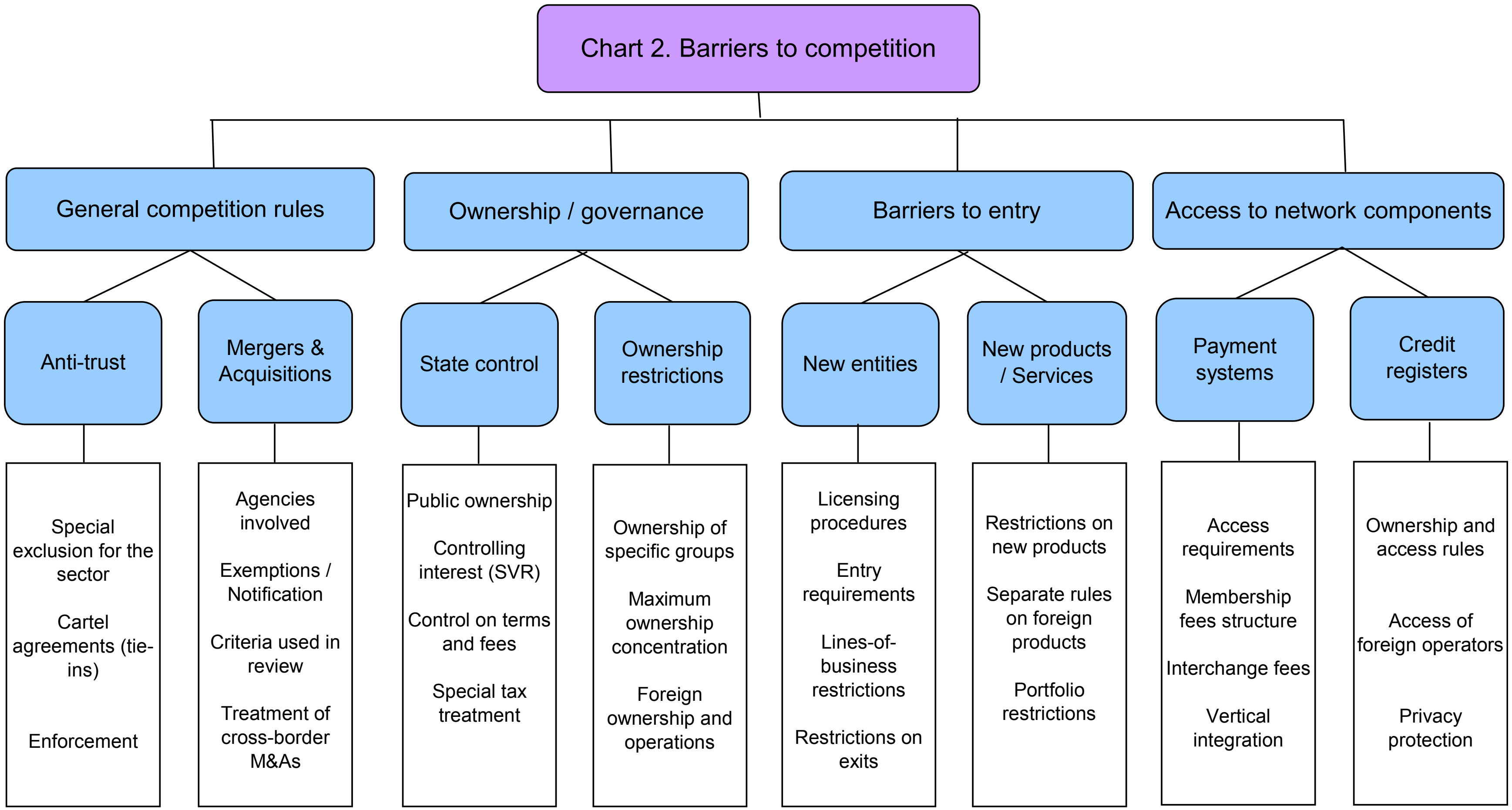
Chart 2. Barriers to competition
General competition rules
Ownership / governance
Barriers to entry
Access to network components
Anti-trust
Mergers & Acquisitions
State control
Ownership restrictions
New entities
New products / Services
Payment systems
Credit registers
Special exclusion for the sector
Cartel agreements (tie-ins)
Enforcement
Agencies involved
Exemptions / Notification
Criteria used in review
Treatment of cross-border M&As
Public ownership
Controlling interest (SVR)
Control on terms and fees
Special tax treatment
Ownership of specific groups
Maximum ownership concentration
Foreign ownership and operations
Licensing procedures
Entry requirements
Lines-of-business restrictions
Restrictions on exits
Restrictions on new products
Separate rules on foreign products
Portfolio restrictions
Access requirements
Membership fees structure
Interchange fees
Vertical integration
Ownership and access rules
Access of foreign operators
Privacy protection

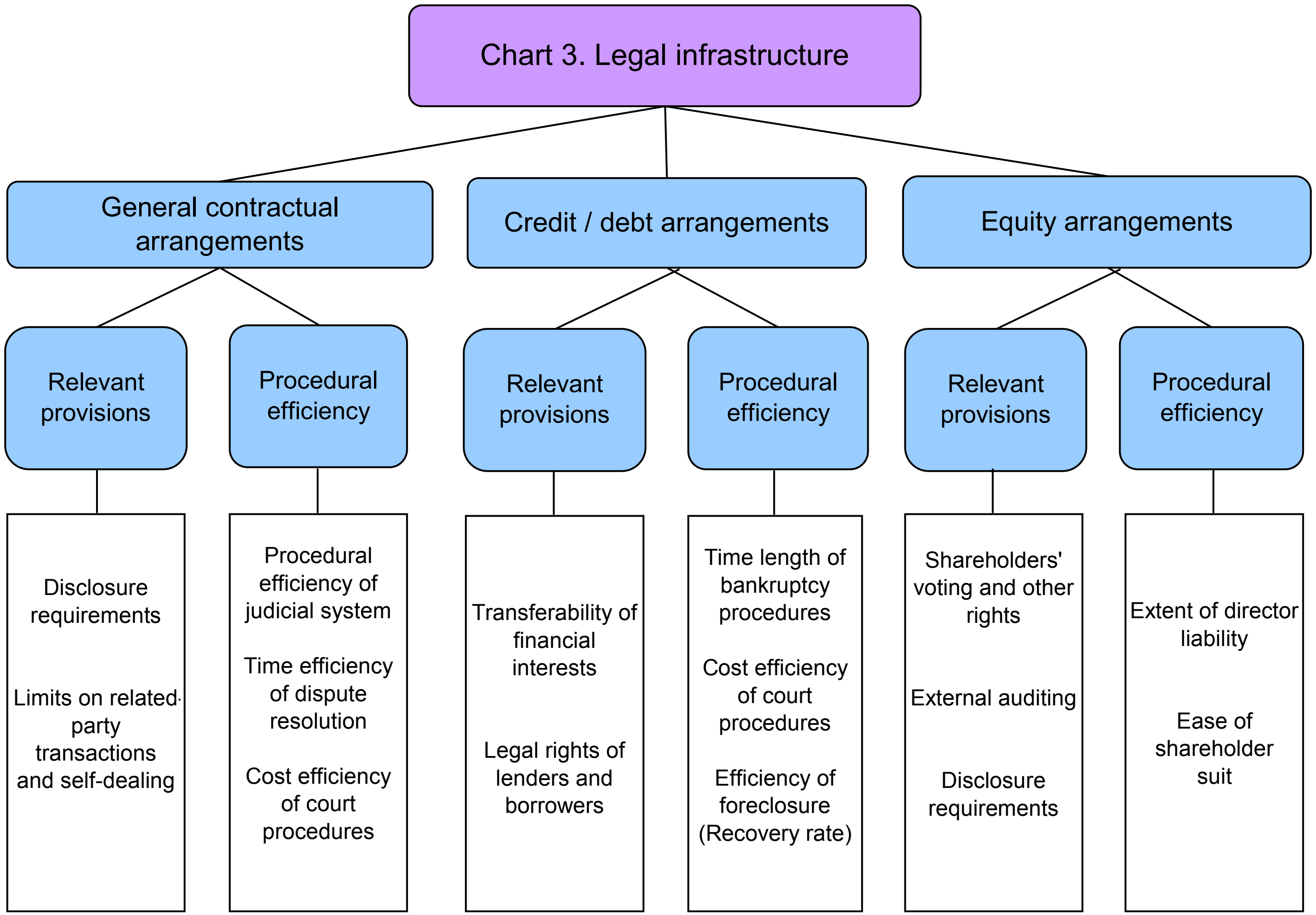
Chart 3. Legal infrastructure
General contractual arrangements
Credit / debt arrangements
Equity arrangements
Relevant provisions
Procedural efficiency
Relevant provisions
Procedural efficiency
Relevant provisions
Procedural efficiency
Disclosure requirements
Limits on related-party transactions and self-dealing
Procedural efficiency of judicial system
Time efficiency of dispute resolution
Cost efficiency of court procedures
Transferability of financial interests
Legal rights of lenders and borrowers
Time length of bankruptcy procedures
Cost efficiency of court procedures
Efficiency of foreclosure (Recovery rate)
Shareholders' voting and other rights
External auditing
Disclosure requirements
Extent of director liability
Ease of shareholder suit

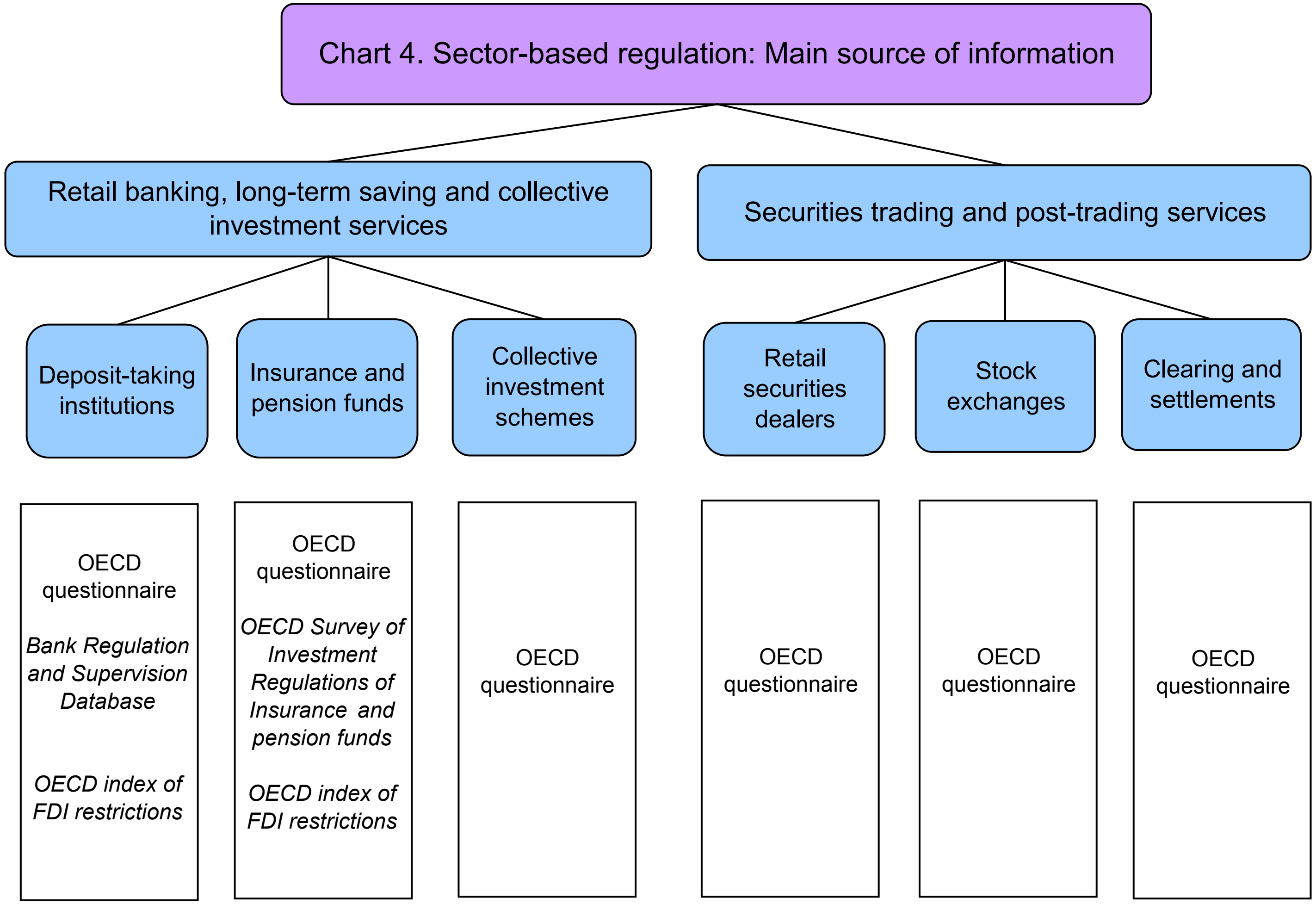
Chart 4. Sector-based regulation: Main source of information
Retail banking, long-term saving and collective investment services
Securities trading and post-trading services
Deposit-taking institutions
Insurance and pension funds
Collective investment schemes
Retail securities dealers
Stock exchanges
Clearing and settlements
OECD questionnaire
Bank Regulation and Supervision Database
OECD index of FDI restrictions
OECD questionnaire
OECD Survey of Investment Regulations of Insurance and pension funds
OECD index of FDI restrictions
OECD questionnaire
OECD questionnaire
OECD questionnaire
OECD questionnaire

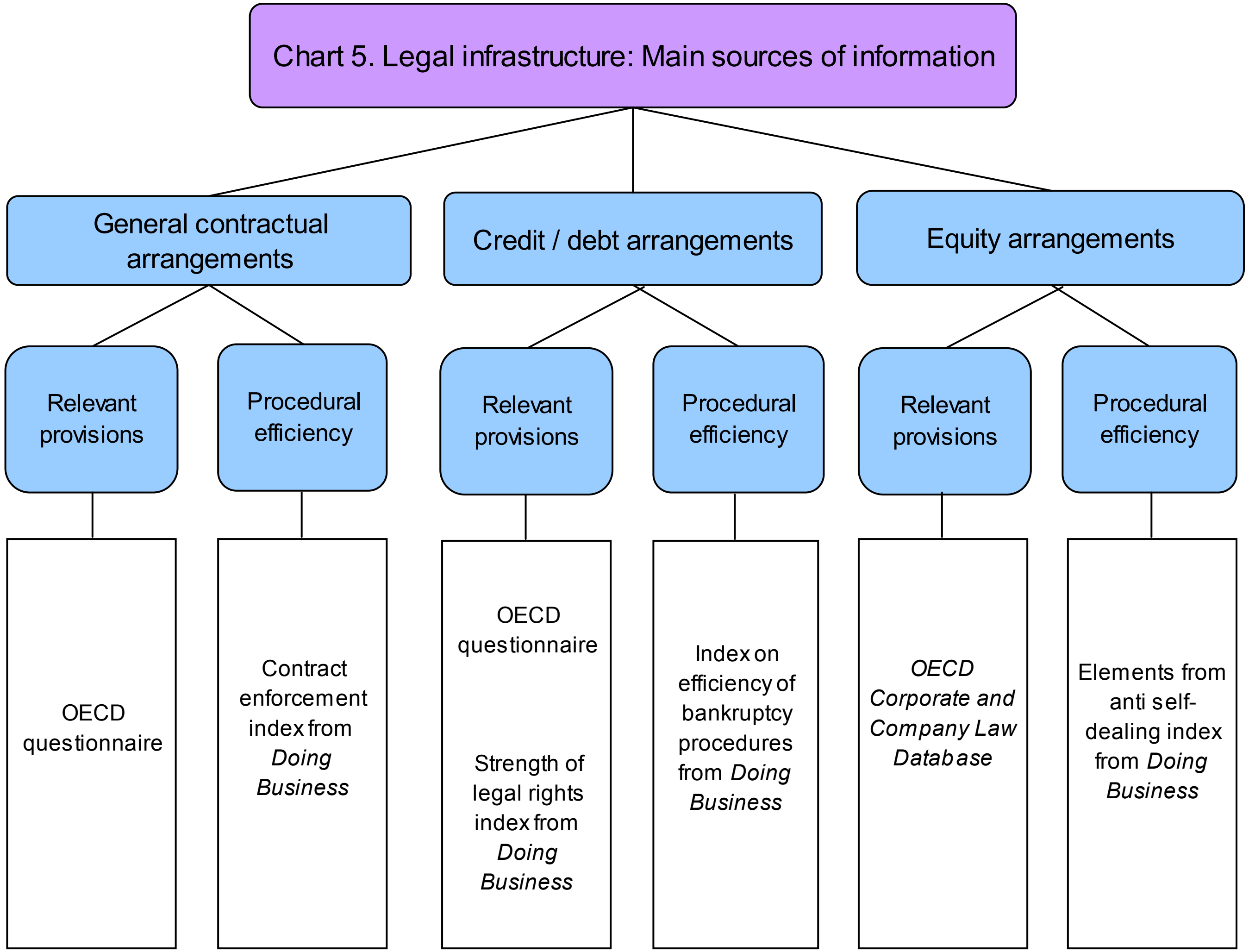
Chart 5. Legal infrastructure: Main sources of information
General contractual arrangements
Credit / debt arrangements
Equity arrangements
Relevant provisions
Procedural efficiency
Relevant provisions
Procedural efficiency
Relevant provisions
Procedural efficiency
OECD questionnaire
Contract enforcement index from *Doing Business*
OECD questionnaire
Strength of legal rights index from *Doing Business*
Index on efficiency of bankruptcy procedures from *Doing Business*
OECD Corporate and Company Law Database
Elements from anti self-dealing index from *Doing Business*