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PRESS RELEASE

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IIF Press Conference. The National Press Club, Washington, D.C., July 17, 2008.
Opening Statement.

Dr. Josef Ackermann

Chairman of the Board of Directors of the Institute of International Finance
Chairman of the Management Board and the Group Executive Committee of Deutsche Bank AG

Good morning. Today we are releasing the *Final Report* of the Institute of International Finance's Committee on Market Best Practices. The Committee comprised senior executives from across the financial services industry and was chaired by Rick Waugh, the President and CEO of Scotiabank, together with Cees Maas, the former Vice Chairman, CFO and CRO of ING. The Committee's work was supported by the staff of the IIF, headed by Charles Dallara. I am delighted that these colleagues are with me here today to present the conclusions of our work.

As I emphasized at the presentation of the Committee's *Interim Report* in April in Frankfurt, the financial services industry fully recognizes its responsibilities. We acknowledge that there were serious weaknesses in the business practices of a number of firms, which contributed significantly to broader problems in the financial services industry and the economy as a whole.

Developments in recent days, including those surrounding the GSEs, have highlighted the continuing problems in financial markets and on the U.S. housing front. These developments underscore the central importance of actions to restore stability and build confidence. We are convinced that the implementation by leading financial services firms of the proposals in the report that we are presenting today will make significant contributions to strengthening the financial system, especially when combined with sustained effective policies on the official side.

Over the past year, a large number of firms have undertaken substantial internal reforms. At the same time, there have been actions by governments, central banks and other public authorities to address critical issues. Nevertheless, a great deal still has to be done to strengthen the financial system and in this context, allow me to make three general, but essential points.

First, the world economy faces strains, not only from a slowing of the U.S. economy, but also because the surge in commodity prices is causing the most serious inflationary challenges we have seen in more than a quarter of a century. To secure non-inflationary, sustainable growth, central banks must not allow inflationary expectations to emerge, let alone become entrenched. At the same time, efforts must be made to address, to the extent possible, supply constraints in those markets where structurally higher demand has increased price pressures.

Second, the turmoil in the financial markets has had a detrimental impact on investor and market confidence in our industry. Today's report is a substantive, thoughtful and wide-ranging response to this. The Principles of Conduct, and the Recommendations aligned to them, are benchmarks for firms to evaluate and adjust their practices, as and when needed. We also offer Considerations for the Official Sector, which we hope will be useful as government authorities seek to enhance the efficient and effective regulation of firms and reinforce the stability of the financial system. Our challenge now is to move forward with effective implementation, and we are determined to do just that.

Third, we must not only address the evident weaknesses in present business practices, but we must also act to reduce the risks of similar crises in the future. In addition to taking appropriate action within our own firms, we have to:

- actively pursue our dialogue with regulatory, supervisory and standard-setting authorities; and
- strengthen the monitoring of market developments to increase broader awareness of emerging vulnerabilities.

Our report today addresses these three matters.

The *Final Report* has been developed and reviewed by many of the leaders in our industry. It reflects the agreement of these leaders on ways to correct shortcomings in the areas of risk management; compensation policies; liquidity risk, conduits and securitization; valuation; the ratings process and credit underwriting issues; as well as transparency and disclosure.

It is important to emphasize that our objective in the Committee and on the IIF Board of Directors was to develop approaches that could be supported and implemented by a broad majority of companies in the industry. My colleagues and I here today are confident that there will be very significant implementation. And, we have agreed that the IIF will develop a process to work with firms on implementation and monitoring performance.

Now, there are of course a number of issues that cannot be resolved by the industry alone and which need to be subject to exchanges of views with the authorities. For example, we have called for a dialogue on fair value accounting involving all the stakeholders to address a range of complex issues, including the critical question of its impact on procyclical movements in financial markets. I am pleased to say that a dialogue is moving forward and Cees Maas will say more about this topic in a few minutes.

On the issues that can be addressed directly by the industry, and these constitute the bulk of the report's contents, the Committee has achieved its goal through its intense efforts and because there is a sense in the industry that this is a time for serious cooperative action.

The central issue for improved performance by financial services firms, which Rick will expand upon shortly, is risk management. The Committee has placed the highest priority on this subject. As the first Principle of Conduct in this report states: "A robust and pervasive risk culture throughout the firm is essential. This risk culture should be embedded in the way the firm operates and should cover all areas and activities, with particular care not to limit risk management to specific business areas or to have it operate only as an audit or control function."

The crisis that we have seen highlights the need for all financial firms to make sure they have robust governance and sound risk management systems.

As journalists you are certainly aware of the vital role that transparency and disclosure plays. Our report is a call for our industry to strengthen both. In addressing the crisis over the last year, many financial firms have already raised the level of their communications to investors, counterparties and the general public. We recognize that the better and more reliable the information we provide on our activities, the greater the public's trust will be.

Compensation policies have been a particular focus of interest in the past several months. This report represents an unprecedented effort by the industry in this domain. We believe our proposals can make a difference as firms move ahead on this issue.

Our report includes a series of Principles of Conduct on compensation that can provide valuable guidance to individual firms. Let me quote from the first three Principles of Conduct that we have agreed upon:

First, compensation incentives should be based on performance and should be aligned with shareholder interests and long-term, firm-wide profitability, taking into account comprehensive risk and the cost of capital.

Second, compensation incentives should not induce risk-taking in excess of the firm's risk appetite.

Third, payout of compensation incentives should be aligned with the timing of full and final realization of related risk-adjusted profit.

In addition – and this is an important point – we focus on severance pay. Our report stresses that firms should take into account the performance realized for shareholders over time in determining severance pay.

Our report covers many other areas, and my colleagues here today will be highlighting some of them for you. I would like to mention just one more important proposal. We are establishing a global financial Market Monitoring Group (MMG) for the better and earlier detection of new, emerging vulnerabilities in the markets and the financial system. This is a major initiative. We believe that the timely assessment of market developments with systemic implications by a select group of senior executives from our industry and seasoned veterans can contribute to better risk management by our sector's firms.

By drawing on the wealth of its members' experience, the Market Monitoring Group can contribute to a greater awareness of the potential areas of systemic stress. What is unique about this approach is that the input will be from market participants and experienced practitioners.

In concluding, let me note that as we have moved ahead, so too have the regulatory authorities and there is a great amount of convergence. I would like to underscore that today's report does not represent an alternative between self-regulation and new regulation. What we can quite clearly see is that it is essential for the industry to reform and that there is an emerging consensus on the benefits of reinforcing these self-corrections through improved regulatory incentives and structures.

I would now like to hand over to the Co-Chairs of the Committee for their comments. Rick will be highlighting, in particular, issues in connection with risk and liquidity management as well as ratings. Cees will introduce the findings of the report with regard to valuation as well as some of the considerations we have included in the report for public authorities.

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Mr. Rick Waugh

Co-Chairman of the IIF Committee on Market Best Practices, Member of the IIF Board of Directors.
President and CEO, Scotiabank.

Good morning. Thank you, Joe, and good morning. Co-chairing this Committee has been a remarkable experience. Together with its Working Groups we have seen more than 100 senior executives, from 70 firms, representing most of the leaders in the industry, engaged in a process to which they and their firms have attached the highest priority.

We have all participated in this special IIF initiative with a clear understanding that we need to formulate Principles of Conduct and best practice Recommendations that will be widely implemented and that will strengthen our industry significantly. This has been, in my experience, and perhaps in that of the global financial industry, an unprecedented and unique undertaking. A quick perusal of the names of the participants will give you a sense of the seriousness the industry has given to this project.

Many very complicated issues have been thrashed out. I am confident that in the months ahead it will become increasingly evident that a very large number of firms will be very carefully reviewing many of their practices in light of our *Final Report* and that, as a result, we will be seeing significant industry improvements in risk-management and governance standards. While a number of firms are already meeting many of the leading practices, it is clear the financial sector as a whole needs to do much better. Taking measures in line with the Principles of Conduct and the Recommendations that we have proposed in this report will not only serve as a significant contribution to best practices, but as a platform and reference point for going forward.

We are gratified that overall, we reached similar conclusions to the Senior Supervisors' Group, which pointed out "leading practices" that helped some firms avoid, or to cope effectively, with the problems that arose in this difficult time of market turmoil. There is a high degree of congruence between those "leading practices" and many of the recommendations in our report. This is also the case with regard to the views of the Financial Stability Forum that noted in its report in April that, "Authorities should not pre-empt or hinder market driven adjustments, but should monitor them and add discipline where needed."

Dr. Ackermann has already introduced the subject of risk management, which is at the center of this report, and for a very important reason. Risk management should be our core expertise and what determines, to a large extent, our individual success as firms and ensures a positive contribution to efficient financial markets. The best firms have gotten this right more times than not. Those who strive to be the best will see it is to their advantage to implement these best practices as it relates to their own circumstances.

Our industry has made mistakes and for some, this has been very costly, but our industry's role and expertise is essential in the financial markets and for the future of growing global economies. There is a need in many institutions, we believe, for improved oversight by boards of directors on risk management and for strengthening senior management engagement in both current risk issues and in forward-looking strategic risk management analysis.

Our report also covers several key risk management practices. And here let me highlight a few of our recommendations. We note that firms should make clear that senior management, in particular the CEO, is responsible in this area and that the CRO has the ability to influence key decision-makers in the firm with the mandate to ascertain that the firm's risk level is consistent with its risk appetite and provide a thoughtful, integrated view of the overall risks the firm faces.

Our recommendations also emphasize that stress testing should be an integral part of assessing the bank's risk profile in relation to its risk appetite across all business activities, risk types and exposures. Further, we point out that firms should ensure that risk management does not rely on a single risk methodology.

We support the many benefits of the originate and distribute models, but the over-reliance on this model to distribute risk has been a major contributor to this current crisis. Many of our recommendations and principles, throughout our report, try to address its shortcomings.

The success of the approaches that we are advocating demands a greater degree of relevant transparency and communication by the financial sector than before, but the emphasis is on relevant disclosure, rather than just more. This applies just as much to internal information systems within firms, as to information exchanges with counterparties, supervisors and the broader public. We believe this is essential.

Another major area of the report relates to the specific problems that have come to the forefront in the crisis over the last year and that have concerned structured products and liquidity risks. This has been a very serious area of weakness. We underscore today that it is important for firms to ensure implementation of the recommendations that were detailed by the IIF more than a year ago in its report, *Principles of Liquidity Risk Management*, which are updated and supplemented in our *Final Report*. While it was only a year old, more focused implementation of the recommendations would have lessened the crisis.

We agree with the conclusion of the official report by the United Kingdom Financial Services Authority (FSA) in its *Review of the Liquidity Requirements for Banks and Building Societies* (December 2007), that the onus is first on banks and not the official sector to be responsible for effective management of liquidity risk and the maintenance of adequate liquidity. We recognize our responsibility to ensure that we apply sound industry practices, as set out in the Recommendations, in this critical area.

Liquidity-risk management practices need to be tailored to each firm's business model and market participation. Each firm must determine its risk tolerance and the best way to combine prudent risk management practices within its business strategy. This is an area where judgment is vital and we underscore in the report that supervision and regulation should recognize firms' tailored approaches and focus on their overall effectiveness, not overly prescriptive rules. Even the most prudent regulations cannot and will not guarantee avoidance of this risk.

Just as it is important to create a strong risk culture in each firm, it is also important to create a well-understood and resilient liquidity culture, so that liquidity issues and costs are taken into account in planning, product design and decision-making at multiple levels in the organization. Here again, it is essential that there be good sharing of information within the firm, including the appropriate treasury or finance functions. There has to be sound contingency planning in this area and stress testing to review the models that firms are using.

In this brief introduction, permit me to turn to a couple of related topics that have involved a great deal of public discussion in recent months: namely, the lending and due-diligence standards in the U.S. mortgage and mortgage-backed securities (MBS) markets, and in the markets for a range of structured financial products.

As you know, mortgage brokers were arranging loans, and non-bank originators were often making loans, without applying bank-equivalent lending standards. With a particular focus on U.S., this part of our report recommends that non-bank institutions involved with originating mortgages should be held to the

same standards as banks with regard to duty of care to borrowers on product suitability, and in terms of standards of due diligence, credit assessment and continuing loan management.

In many instances we saw how competitive pressures significantly weakened these standards. Our report is also blunt in suggesting that our own member financial institutions involved in the originate-to-distribute process should make sure adequate due diligence is conducted at all stages to maintain the integrity of the process. Indeed, financial institutions should apply the same credit due diligence for structured products that they plan to originate and distribute, as they do similar assets that are to be carried on the firm's own balance sheet. We should not only ensure this, but the investors should demand this and factor this into their investing decisions.

In addition, while substantial amounts of information have been developed in the securitization process in the past, it hasn't always been very usable, nor have investors always taken full advantage of it. We recommend that originators and underwriters should disclose, on a timely basis, clear and well-targeted information about structured products and their underlying assets to investors and rating agencies

We have not only highlighted the need for improvement by underwriters and distributors, but also by the ratings agencies. The work of the rating agencies, has been found wanting, particularly with regard to structured financial products.

We have concluded that the market needs to have confidence restored by the rating agencies and be assured that internal processes within the agencies are backed up by robust review and validation of models and assumptions, and that they have the data and systems to support development and ongoing monitoring of ratings. Models and processes used by the rating agencies to rate structured products should have independent, internal validation and monitoring. And while our rating agency members did not agree, it was the consensus of our Committee that an external, independent evaluation of these processes should be required.

As I noted earlier, this report is the result of a great deal of serious input. Its recommendations provide a strong foundation to restore confidence in financial markets during this current challenging period and to help ensure the industry is prepared for future challenges.

But it is also important to remember that risk management is an art, not a science – although many have tried unsuccessfully to make it so. Not all risks can be distributed or managed as planned.

Crises will occur again. Attention to this report, and adherence to its principles and recommendations will mitigate the impact of future crises on those participants who strive to utilize those parts most relevant to them.

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Mr. Cees Maas

Co-Chairman of the IIF Committee on Market Best Practices and former Vice Chairman of the IIF Board of Directors. Former Vice Chairman, CRO and CFO of ING Group.

Good morning to all of you. Today's report includes a substantial discussion of valuation issues, as well as a number of considerations that we have concluded ought to be brought to the attention of the regulatory and supervisory authorities, as well as to the accounting standard-setters.

It has been a privilege for me over the last few years to have been involved in many of the regulatory areas of the IIF's work and to have engaged with the official authorities, the accounting standard-setters and the Accounting Task Force of the Basel Committee on behalf of the Institute. One of the most important efforts that we have consistently promoted has been effective regulation - highlighting the need for a more efficient system. We have also consistently advocated convergence of international and U.S. accounting standards. Now, against the background of the turmoil of recent times, I believe there is greater recognition in the industry and in the regulatory community of the need for joint efforts to look at the lessons learned and consider reforms.

Within the broad range of issues that need to be addressed, few are more complicated than valuation. Our Committee has articulated Principles of Conduct and Recommendations in the report to assist firms to maintain robust valuation processes in accordance with applicable accounting and regulatory guidance, incorporating critical expert judgment and discipline as well as the most appropriate inputs available. We suggest that firms need to ensure consistent application of independent and rigorous valuation practices, and they need to apply expert judgment and discipline in valuing complex or illiquid instruments, making use of all available modeling techniques and external and internal inputs such as consensus pricing services while recognizing and managing their limitations. This is an area that calls for greater transparency to improve public understanding of the valuation process.

As we have made many recommendations in the report, so we have also recognized that the time has come to consider important reforms in the broader system itself. Here we agree with the Financial Stability Forum when it suggested in its April report that, "further work (involving the industry, standard-setters and appropriate regulators) is needed to provide confidence that valuation methodologies and related loss estimates are adequate, to clearly highlight the uncertainties associated with valuations and to allow for more meaningful comparisons across firms."

We consider it is essential that accounting standard-setters and the appropriate authorities review the unintended consequences and lessons learned of the recent turmoil on a number of levels. We underscore that fair value accounting remains an essential element of global capital markets and that changes in elements of current approaches can add to concerns at a time of market strain.

We do feel there is a need for an open-ended dialogue involving all the stakeholders that would include clarification on a number of fronts, such as pricing inputs in illiquid markets, and consideration of refinements in valuation methodologies and greater flexibility regarding the transfer of assets between accounting categories - that is, between trading and other categories. Such a dialogue would also address concerns about the extent to which current interpretations of mark-to-market requirements may contribute to

Statement by Mr. Maas as prepared for delivery.

pro-cyclical effects or market uncertainty. If there are improvements in fair value accounting approaches, then they will need to be on a symmetrical basis and balanced between the upside and the downside. We recognize that views differ widely within our industry and beyond, and our goal at this juncture is to work with others to stimulate an important dialogue.

We endorse pursuing a short-term technical dialogue among firms, auditors, rating agencies, investors, analysts, accounting standard-setters and supervisors to enhance understanding of valuations, exchange views on technical questions about valuations in difficult markets, and discuss how best to summarize for disclosure the uncertainties, assumptions, adjustments, and sensitivities of valuations in the mark-to-market environment, especially where indirect inputs are used or valuations are based on models.

While the prime audience for this report is the financial industry, we recognized in the Committee that in a variety of areas market conditions required suggesting actions for the official authorities to consider. In addition to calling for dialogue on valuation issues and central bank liquidity facilities, for example, our report discusses the review of securitization now being undertaken by the Basel Committee and the accounting standard setters. We are engaged at this time in important discussion with the Basel Committee on Banking Supervision, and here I might note that we agree there may be a need for improvements of the Accord.

The most important point that I want to leave you with is that our Committee, as it has worked on these very important and complicated regulatory issues, shares the view of the official regulators that we need to work together in the period immediately ahead to strengthen the global financial system. This requires reforms within firms, it requires greater transparency and public information, and it requires and supervision that both enhances public confidence and encourages innovation and prudent risk-taking by the industry.

Thank you.

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