

**Timothy D. Adams**  
Managing Director

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His Excellency Anton Germanovich Siluanov  
Minister of Finance  
Ministry of Finance of the Russian Federation  
9, Iljinka  
Moscow, 103097, Russian Federation



1333 H Street, NW, Suite 800E  
Washington, DC 20005-4770

TELEPHONE 202.857.3600

FAX 202.775.1430

WEB [iif.com](http://iif.com)

Dear Minister Siluanov:

On the occasion of the first meeting of G20 Finance Ministers and Central Bank Governors under the Russian G20 Presidency, I am writing to you on behalf of the members of the Institute of International Finance to show our support to the G20 and its members, as they strive to take the policy actions needed to boost global output and employment and to safeguard financial stability. Despite recent improvements in economic conditions and in market sentiment, the global economy is still struggling to recover from the deep financial crisis of 2007-09. Global growth in 2012 was anemic, volatile and fragile. Moreover, output in the G7 countries is estimated to have declined in the fourth quarter of 2012 for the first time since 2009. The global growth prospects for 2013 remain disappointingly modest, four years into the recovery.

The private financial community believes that, to promote the shared objectives of enhancing financial stability and boosting sustainable global growth, the official sector must take coordinated policy actions to (a) stave off regulatory fragmentation and recommit to the multilateral approach of past G20 summits; (b) accelerate the needed reforms in the Euro Area; (c) reduce policy uncertainty in major countries, including the U.S. and Japan, by putting in place credible medium-term fiscal consolidation plans; (d) address effectively the policy challenges in emerging markets, including the impact of spillover effects from advanced countries; and (e) prepare for an eventual exit from the current quantitative easing in major mature market countries. The private financial community, for its part, recognizes its critical role in providing sustainable credit supply to the real economy. It stands ready to work closely with the G20 and the official sector toward achieving our mutual goals.

**Avoiding Fragmentation:** Unilateral regulation of financial services by individual jurisdictions— notwithstanding commitments to international coordination and reliance on home supervisors—is on the increase and threatens to reverse recent progress toward a more coordinated global system. This trend to a more territorial approach, especially ring-fencing assets, capital and liquidity, threatens not only to undo recent movement toward regulatory cooperation under G20 initiatives, but also to set back earlier achievements of cross-border cooperation that have helped fuel global economic growth. This would inevitably have a negative impact not only on banks but also on non-financial corporations engaged in global trade.

We urge the G20 to recommit to the ethos of global harmonization and consistency and to support the institutions set up to achieve them. Accordingly, we believe it would be helpful if the G20 could reinforce the central role of the Financial Stability Board (FSB) in coordinating the development, timely adoption and consistent implementation of international global financial regulatory standards, including the Basel III regulatory framework. The FSB's clear focus on consistency of design and implementation of international regulatory standards remains vital, but there is a growing need for the FSB to be encouraged to address the effects of unilateral, protectionist, or extra-territorial regulatory measures by member states. Policymakers and the financial industry should continue efforts to establish workable cross-border resolution mechanisms for financial institutions. In addition, as we begin to see some early signs of economic recovery, it remains critically important to reduce procyclicality as much as possible in the design and implementation of regulatory reforms, and to take steps to address unintended constraining cumulative effects of reforms (not just the core Basel III program) on end-users of credit and financial products. The combined impact of new collateral requirements and the new liquidity requirements on global markets and end-users' ability to manage their risk is a case in point.

**Avoid any perception of complacency and accelerate the momentum of reforms in the Euro Area:** While the Euro Area authorities and the European Central Bank (ECB) have taken strong policy decisions in recent months that have reduced tail risks, improved market confidence, and reduced sovereign bond yields in stressed countries, policymakers must continually push forward to implement fundamental policy decisions to strengthen the monetary union, stimulate growth and resolve the sovereign debt crisis. The Euro Area authorities have established credibility through building reform momentum in several critical policy areas, which it is critical to maintain and augment. First, there is a need to move decisively toward setting up a single supervisory mechanism at the ECB and common deposit insurance and bank resolution frameworks. There is also a need to remove the claims to seniority in the European Stability Mechanism (ESM) Treaty that would subordinate private investors and to introduce meaningful and workable arrangements for direct bank recapitalization by the ESM, in order to break the vicious linkage between sovereign and bank balance sheets, which market participants view as essential for the Euro Area to exit the crisis. The Euro Area authorities and institutions should also do what they can to assist program countries to regain full market access—which is critical to debt sustainability. In parallel, the authorities should establish a credible and sufficiently ambitious roadmap for enhanced fiscal integration.

**Put in place credible medium-term fiscal frameworks in the U.S. and Japan:** Helped by bold policy initiatives, the financial health of the **U.S.** private sector (households, banks and corporations) has improved significantly, laying the foundation for a sustained recovery. However, the markets still fret over an apparent lack of political consensus and the uncertainty surrounding the appropriate content and pace of fiscal consolidation. Markets largely discount short-term fixes and seek timely agreement on the immediate priorities of how to avoid expenditure sequestration and raise the debt ceiling, in the context of a balanced, credible and comprehensive multi-year fiscal consolidation plan. As with the U.S., **Japan** gets decreasing impact from short-term partial fixes and needs to adopt a comprehensive program of structural and fiscal reforms. More specifically, the markets are looking for a credible medium-term fiscal consolidation plan—building on the announced indirect tax increases—that deals with the long-term impact of a rapidly aging population and puts the large outstanding public debt on a sustainable path.

**Policy challenges in major emerging markets:** Policy measures in developed economies have led to strong spillover effects requiring policy actions in the impacted economies. **China**, under its new political leadership, is addressing the vulnerabilities posed by the strong credit expansion and taking steps to enhance the efficiency of the financial sector, reform the tax system and other structural reforms needed to help rebalance the domestic economy toward consumption-led growth. **Brazil** is pursuing structural reform efforts to build upon its strengthened macroeconomic position and achieve higher noninflationary self-sustaining growth. Similarly, **Russia** is working on structural reforms to encourage private sector investment to strengthen potential output growth and reduce the economy's dependence on the energy sector. However, sluggish foreign demand, potentially tighter global liquidity and competitiveness pressures look likely to weaken output growth in 2013, even with oil prices remaining near their current levels. **India** has made progress through the recently launched reform program that has cut energy subsidies, reinvigorated fiscal adjustment and eased the barriers to foreign investment. These reforms are expected to facilitate a recovery in output growth and stem macroeconomic imbalances. We support all these initiatives and encourage continuing progress in their implementation.

**Address the challenges posed by an eventual exit from quantitative easing:** The major central banks' bold policy actions of near zero-interest rates, quantitative easing and other non-standard monetary policy measures have, as planned, reduced market risk aversion and tail risks and supported growth. However, they have also created distortions in asset prices and posed spillover effects for emerging markets. As we go forward from here, the challenge clearly is for both mature and emerging market economies to develop appropriate strategies and macro-prudential policies to deal effectively with the eventual reversal of low-interest rate policies and quantitative easing, the reduction of central bank balance sheets and the associated impact on credit expansion, asset prices and investor sentiment. As part of these strategies, we believe major central banks should focus on enhancing their coordination, especially of their communication strategies, to guide market expectations and thus help avoid a disorderly interest rate adjustment process and undue exchange rate volatility.

**Enhance the effectiveness of policy coordination:** Against this background, resolute leadership is needed to address the root causes of subdued recovery, attenuate the short-term risks, and put in place appropriate, credible medium-term policies and regulatory reforms at the national level, with determined and judicious

coordination at the global level, so as to achieve shared objectives for output growth, effective regulatory frameworks, open trade and free capital flows. Unilateral actions or short-term fixes at the national level would undermine the policy coordination process. The IMF and other bodies have developed a number of new useful instruments and tools of policy coordination (such as the Spillover Reports and the Pilot External Sector Report), but their effective use in guiding policy coordination requires first and foremost strong political commitment and leadership. The central role of the FSB in coordinating regulatory reforms should also be reinforced. The private financial community would also urge the G20 to express support in its communiqué for the *Addendum to the Principles for Stable Capital Flows and Fair Debt Restructuring* to help strengthen the framework for voluntary market-based sovereign debt restructurings when needed. The original *Principles* were endorsed by the G20 in Berlin in 2004.

To achieve faster and more balanced economic growth, create jobs, minimize possible destabilizing policy distortions and build a more stable and supportive financial sector, we believe the G20 must reinvigorate the policy coordination process and recommit to the cooperative spirit of the London and Pittsburgh G20 Summits. While all members of the G20 can contribute toward this objective, a leading role and contribution by major mature and emerging market countries would be particularly important and decisive. The international financial community stands ready to do its part and cooperate with the official sector to address these challenges.

Best regards.

Sincerely,

A handwritten signature in black ink, appearing to read "Timothy D. Leach". The signature is fluid and cursive, with a long horizontal stroke at the end.

cc: G20 and IMFC Finance Ministers and Central Bank Governors