EU plans market reforms to avert crisis

By Tony Barber in Luxembourg, Guido Bohsem in Berlin and Mark Schieritz in Frankfurt

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European nations are to draw up radical proposals to improve transparency in financial markets and to change the way credit rating agencies operate in an attempt to prevent any recurrence of the financial turmoil arising from the credit squeeze.

A roadmap of reforms was being drawn up by eurozone finance ministers last night including fuller public disclosure of activities involving special investment vehicles set up by banks.

The finance ministers, meeting on Sunday night in Luxembourg, were poised to call for a close examination of the role of credit rating agencies, especially in relation to structured finance instruments, conflicts of interest, transparency of rating methods and delays in reassessing ratings.

The drive comes as some members of the Group of Seven leading nations prepare to launch joint action to avoid future market turmoil at their autumn meeting this month.

The most radical step being considered by the G7 would be to force rating agencies to split their rating business from their consulting activities, a person close to the G7 told FT Deutschland, the Financial Times' sister paper. This was intended to prevent any potential conflicts of interest.

Other options include forcing agencies to provide ratings not only for creditworthiness but also for liquidity risks and limiting the use that public institutions such as central banks or governments make of ratings.

All G7 members have agreed reforms are needed, including the US, which had formerly resisted joint action, according to a person close to the G7.

"This will be about changing the rules of the game," the person said.

Christine Lagarde, French finance minister, also has called for securitisation to be subject to some standardisation, so there would effectively be a limit on the complexity of instruments.

Writing in the Financial Times, she also calls for tighter regulation of unregulated entities that generate loans and then pass on the risk to others: "These entities face hardly any incentives for controlling credit risk other than market discipline. This contrasts with the more traditional situation of regulated banks."

European Union experts argue the turbulence affecting financial markets in August and September was connected partly to lack of fast, reliable information about which institutions were exposed to credit risk by using complex financial instruments.

An EU experts' document, prepared for a meeting of the eurozone finance ministers in Luxembourg on Sunday evening evening, states: "The opacity of these instruments, combined with credit risk dispersion, has made it difficult to identify the exact size and location of losses, thereby undermining investor confidence in financial markets more generally."