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Introductory Report

In the past few years, the international financial system has been characterised by unprecedented development, which has been fostered and accelerated by a substantial increase in the levels of market integration.

Financial globalisation has led to a significant reduction in transaction costs and, at the same time, has ensured a considerable increase in global financial resources.

As a result of the ability of the markets to promote the efficient allocation of wealth on a global scale, **significant economic growth has occurred**.

This growth has made it possible to achieve results in countries that, until only a few decades ago, would never have been able to aspire to becoming participants in the international economy.

In Europe financial integration has played an important role in supporting the broader process of European integration, often acting as a driving force and stimulus to the slower process of political integration.

This strong growth in the financial markets has also been maintained by the development of new products for management and risk coverage.

Because of the strong interdependence of the markets, many of these products have, however, given rise to **new areas of risk** and an unprecedented increase in the transmission speed of both positive and negative economic and financial forces. Some financial institutions have engaged in conduct mainly focusing on short-term gains, which in some cases resulted in business models with too great a division between the credit organisation stage and the subsequent management of the risk inherent in such portfolios.

The first signs of the unsustainability of this development model occurred in 2007 with the subprime loan market crisis, but the turning point really came with the failure of Lehman Brothers last September.

The resulting shock aggravated the situation even further, leading to a considerable increase in the already high level of volatility in the markets.

The gravity of the crisis was recently confirmed by the forecasts issued by the International Monetary Fund, estimating that the reduction in the growth of the global economy for 2009 will be even more severe than predicted last November.

If we consider that these forecasts already take into account the effects of the considerable fiscal stimulus measures that have been adopted in most western countries, we realise the extraordinary gravity of the situation that we are facing.

In this context it is obvious that **the instruments and institutions of international governance, supervision and control are not sufficient** to adapt to the speed at which new financial products and services are being created.

We must, however, admit that the monetary and political authorities have responded quickly to the crisis, using all of the tools at their disposal to avoid a systemic crisis and generalised credit crunch, and to mitigate the effects of the recession.

At the European Union level, too, considerable action has been taken and, particularly during the initial phase, the major countries have succeeded in implementing well-coordinated measures.

Today, however, we know that we must pursue these avenues with greater conviction, because the inadequacy of the coordination efforts in itself harbours **the risk of adopting nationalistic and protectionist trends**, which are all the more dangerous as they are conducted using new technologies that are less visible than in the past.

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There has been considerable uncertainty on all of the international markets, which has been aggravated by a complete absence of clear information on what is happening, on the wide extent and the depth of the crisis and particularly on time frames.

The total absence of information in a market that for years have received enormous flows of economic and financial forecasts, has triggered an **unprecedented loss of confidence**.

The disruption of the equilibrium that had been maintained for many years was an unforeseeable event, as unexpected as the sequence of events that followed.

There is no doubt that the financial crisis that we have been experiencing these last few months is, above all, a loss of trust, exacerbated by the high levels of integration of the international financial markets.

This crisis, which is particularly deep and completely generalised, **threatens the credibility and reputation of the financial system**, even within the system itself.

It is quite clear therefore that, in order to emerge from this cycle, **we have to re-establish an adequate level of trust among market participants.**

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This process will not be easy and in order to tackle it, we must be fully aware of the necessity of **acting quickly.**

It is also essential that we realise that rebuilding trust is not something that can be done in the short term, but will require a period of time that is directly proportional to the extent of the trust that has been undermined.

It is equally important to recognise that we must rebuild confidence among the entire group of stakeholders that have been affected.

We will have to engage in a collective process to conduct analyses, discussions and mediation, with a particular focus on transparency.

In order to regain the confidence that will allow us to put the economy on a path towards solid growth, all of the parties involved must do their part. It should be acknowledged that all of the stakeholders have already taken steps in the right direction, but it should also be pointed out that it is essential not only that we continue, but that our efforts be combined with increasing levels of cooperation.

The political commitment to act that has been demonstrated by governments has established an initial essential barrier to an expansion of the crisis. The monetary authorities have made use of all of their technical capabilities to inject liquidity and avoid a systemic crisis.

Banks have also been called upon to play their part.

The banks and large financial operators must act to rebuild their credibility, which was so quickly compromised, and demonstrate to the markets their ability to effectively support the economy even in moments of such grave difficulty.

The liquidity shortage requires all banks to conduct a more careful assessment, compared to the past, of the creditworthiness of their clients and to carefully assess the "cost" of the risk.

However, in this difficult context, the more the banks are able to guarantee the required support for the best economic initiatives, the more obvious their entrepreneurial abilities will be to the markets.

Until now, the Italian banks have shown that they are able to manage this task, as confirmed by the figures showing that total investments in 2008 are expected to be over two percentage points higher than the figures for the previous year.

The resources that governments have made available to support the capitalisation of banks in preparation for a particularly difficult year for the global economy, will be distributed to provide support for businesses and families.

Today, more than ever, the banks must be able to determine quickly the current needs of their clients and, just as quickly, provide solutions for them in terms of products and services that are truly able to meet these needs.

In such a delicate phase of the economy, banks should offer **products that are simpler** than in the past, **completely transparent** and **easy to price**.

In addition to making these apparently simple choices, many banks should be conducting a thorough review of their business models. These banks should focus primarily on their commercial banking activities and, above all, keep the risks tied to investment products internal.

The large international groups will shoulder greater responsibilities, associated mainly with the need to avoid the hidden dangers behind new protectionist pressures. These banks will have to maintain a careful balance, consistently seeking to support only the best economic initiatives, where these are introduced, in the medium and long term.

In this regard it is important that, when redesigning supervisory rules, the authorities recognise the unique nature of international credit groups, which require solutions that are capable of overcoming the current excessive fragmentation.

In order to rebuild trust with their customers, banks will have to refocus on their ability to be **close to the grassroots**, which is a goal that can be achieved only by a closer **dialogue with all stakeholders**.

It is clear that the banks that have always been strongly grounded in their communities will have a significant advantage in respect of this process.

It is equally obvious that banks will be able to make their business sustainable over time only by proving their reliability, thereby contributing to economic growth, so that we can finally pull out of this crisis.

To assure the markets and businesses that the crisis will not be repeated, **many aspects of international governance**, supervision and international regulation will have to be revised.

Such a process will allow the financial system to create the basis for reviving the entire economy.

We are all quite aware how difficult it will be to redefine a new regulatory balance at an international level. However, we also know that **the extraordinary gravity of this crisis provides an opportunity to make changes to this balance**. This means that, today, the markets have a historic opportunity to improve the global governance system.

In defining this new balance, we must be very careful not to risk destroying the important progress that has been made, often with considerable effort over the last few years, in terms of integration and market development.

We must be fully aware that we are faced with an essential objective not only terms of **achieving better regulation**, but primarily from the point of view of promoting the fastest and most viable path to economic recovery.