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SWIFT Institute publishes new paper on financial stability

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New paper examines the basic criterion necessary for regions to obtain financial stability and avoid a repeat of the financial crisis impacting the industry since 2008

Brussels, 10 December 2014 – New paper from the SWIFT Institute outlines the basic criteria the financial industry should embrace to achieve financial stability in a geographically integrated financial market. Based on a theory of optimal financial areas (OFA), Professors Erik Jones and Geoffrey Underhill revisit the European economic crisis and explain how such a crisis could be avoided in other integrated financial markets.

Drawing on lessons from the European crisis and from the experience of financial market integration within the United Kingdom, the United States and Canada, the paper highlights the six criteria in the theory of 'optimal' financial areas and then explains the consequences of choosing to ignore or reject specific recommendations.

The six criteria include:

- 1) A common risk-free asset (currency and debt instruments) to use as collateral for liquidity access and clearing as well as a refuge for capital 'fleeing to quality' in times of distress;
- 2) A central system of sovereign debt management;
- 3) Centralized counterparties such as exchanges, clearing agents, and depositories;
- 4) A common framework for prudential oversight;
- 5) Emergency liquidity provision that includes lender-of-last-resort facilities for the financial system and the sovereign; and,
- 6) Common procedures and orderly resolution mechanisms for financial institutions and public entities.

"This list of institutional arrangements is not exhaustive but it does represent the greatest points of overlap between the national cases that we examine in the research," says Erik Jones, Johns Hopkins University School of Advanced International Studies (SAIS) and Nuffield College. "Based on the research, each criterion is a necessary ingredient of stability, and the synergetic combination of all six may be considered sufficient to provide stability."

The first three criteria relate to the technical substructure of markets and serves as an *ex ante* underpinning for confidence in the financial system. The last three criteria relate to the challenge of preventing instability and active market stabilization in times of distress. According to the authors, the value-add of this framework is that it concentrates the debate on the political economy of finance, which focuses the attention on how the financial industry should be brought into the conversation in order to share best practice and to strengthen institutional design.

"What is true for Europe is true elsewhere as well," says Geoffrey Underhill, University of Amsterdam and SAIS Europe. "A theory of OFA could be applied to other parts of the globe where national policymakers seek to integrate financial markets either within or across national boundaries. This research offers the opportunity to help those policymakers engage in a transparent debate about the institutional preconditions for stable financial market integration. It offers a checklist of best practices and a cautionary note about the costs of non-compliance."

Please [click here](#) for a summary of the paper. For a detailed copy of the research paper, please contact the [SWIFT Institute](#).

About SWIFT Institute

The SWIFT Institute, managed by SWIFT, funds and publishes independent research bringing together academics and practitioners from the financial services industry. The research is conducted by academics and senior industry professionals and focuses on topics important to the global financial community. The goal of the Institute is to extend the understanding of current practice and future needs in global financial services. The Institute fosters independent research by giving grants, access to research data and publication opportunities for approved projects. The Institute also acts as a catalyst for bringing the SWIFT community and academics together to explore ideas, share knowledge and extend mutual understanding of financial services.

The research covers various aspects of transaction banking, including the following areas: Payments, Clearing / Settlement, Cash Management, Trade Finance, Trust and Securities.

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