A. Introduction: purpose of the presentation

1. Management of systemic risks has become a big cross-disciplinary subject which is currently being dealt with in economics, management, finance, regulatory cooperation and other areas. The reason for that is clearly the recent economic crisis: many countries and many international organizations started research in the field; many discussions take place on different levels (e.g. IMF, Federal Reserve, etc.) to develop efficient policy measures to mitigate systemic risks.

2. Although this subject is mostly associated with finance, the nature of systemic risks is much deeper. Addressing systemic risks is closely related to the fields covered by the activities of the UNECE in general and WP 6 in particular. In this presentation we will show how the work undergoing in the WP.6 can contribute to the management of systemic risks and why this could be one the items on the agenda of the Group of Experts on Risk Management.

B. Which qualities should a risk have so that we could consider it systemic?

3. Most of the existing definitions of systemic risk emerged just recently; since systemic risks are blamed to be the main cause of the economic crisis. One of the broadest definitions of systemic risk is given in the Global Risks Report:\footnote{World Economic Forum, 2010} ‘A systemic risk is the potential loss or damage to an entire system as contrasted with the loss to a single unit of that system’.

4. All definitions outline the following features of systemic risks. In order to consider a risk that, say, occurs within one business organization, systemic, it needs to: 1) have influence on the other players on the market, 2) cause a ‘chain reaction’, and finally 3) damage an entire system. What is important - though most of the definitions come from finance, they do not contain any financial terms: these risks may occur within any system: technical regulation, energy, transport, international trade, customs, etc.

5. Events that later are called ‘systemic risks’ could emerge not only on financial markets. In fact, the recent crisis made systemic risk associated with finance only because it was caused by financial products and because of the financial regulatory system failure. At
the same time, there are many examples of ‘real life’ events that caused systemic collapses: toys crisis in China, fish crisis in Tanzania, etc.

6. Though systemic financial risks are of key importance, we need to remember that financial markets are only ‘derivatives’ reflecting real life behavior. Real life behavior is not regulated by the Federal Reserve, Central Banks, and other financial regulators. It is determined by standardization bodies, technical regulation authorities and other governmental organizations: imposing, for example, an unbalanced technical regulation could cause systemic risks which later will affect the financial markets.

C. What could we do to manage systemic risks? A proposal for a recommendation

7. Management of systemic risk is a new area which, at the moment, is mostly studied by financial professionals. Keeping in mind the features of systemic risks and their ‘not only financial’ nature, the Group could embark on developing methodologies and recommendations for addressing these risks from a broader, ‘not strictly financial’ perspective. Directions could be the following:

i. Development of tools for management of systemic risks requires preparatory work on definitions and classifications. Management of systemic risks by Governments and allocation of responsibilities should be based on clear and explicit definitions and classifications. Systemic risks differ in types, impacts and even systems that they damage; they may come from various fields: energy, transport, international trade, etc. Classifications of systemic risks are important for their proper identification. Group’s agenda should contain the task on elaboration of ‘definitions and classifications of systemic risks’.

ii. Timely and full identification is crucial for mitigation of systemic risks. Governments should have tools for identification of events that may lead to systemic risks. The Group could develop such tools; they should take into account all areas of economic activity and their description could be included into a recommendation providing guidance for Governments on how and where to identify systemic risks.

iii. Systemic risks occur within areas that are both regulated and non-regulated: the roles of different stakeholders in management of risks should be transparent and clearly defined. The Group could develop reference models for risk management processes within regulatory systems and approaches for countering systemic risks within the areas that are not regulated by Governments. These tools and approaches could be further evaluated, verified and finally included into a recommendation.
iv. **Systemic risks occur when regulatory intervention is insufficient/excessive.** On the basis of existing methodologies (e.g. OECD RIA), the Group could further develop tools and recommendations for building a balanced regulatory system: one which has neither excessive nor insufficient regulation. For this purpose, different risk perceptions by various regulatory stakeholders should be taken into account and the problem of determining criteria for acceptable level of risks should be addressed. Approaches for considering different risk perception and for accepting risks by governmental authorities, as well as guidance for achieving a balance with a regulatory system could be included into a recommendation.

v. **Systemic risks occur when risk management activities are poorly coordinated and no one is responsible.** The Group could develop approaches for efficient allocation of responsibilities within governmental structures for coordinating risk management activities. It could imply establishing of an institution responsible for addressing systemic risks. World Economic Forum, in the Global Risk Report examines the idea of a Chief Risk Officer within a Government; allocation of responsibilities is being discussed in the US Congress. This subject should be properly studied and best practice in dealing with organizational issues with regard to ‘high level’ risk management could be included into a recommendation.