

Press release

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Financial Stability Forum reviews vulnerabilities and efforts to strengthen the international financial system

The Financial Stability Forum (FSF), chaired by Andrew Crockett, General Manager, Bank for International Settlements, met on 3-4 September in Toronto. Members focused on a review of potential vulnerabilities in the international financial system. Emphasis was also given to:

- addressing weaknesses in market foundations;
- improving transparency in the reinsurance industry; and
- reviewing progress in offshore financial centres to comply with international standards.

Vulnerabilities in the international financial system

The FSF reviewed sources of potential vulnerabilities in the international financial system. Growth prospects seem somewhat weaker now than at the previous FSF meeting in March and downside risks have increased. However, going forward, moderate growth in major industrial countries was still seen as the most likely scenario.

Risk premia have risen since March. Some special factors have affected individual financial institutions. One consequence to which members drew particular attention is that the process of bank consolidation and restructuring that is under way in some countries will be more important in these circumstances. The experience of the financial sector overall supports the benefits of the considerable investments in risk management that had previously been made.

Risk premia and access to international financial markets for some emerging market economies are other elements of concern. Members reviewed the risks posed by these developments and possible measures to mitigate them.

Members agreed that the current environment and the potential for increased risk aversion call for enhanced vigilance and supervisory cooperation.

Addressing weaknesses in market foundations

The erosion of confidence in the wake of misleading financial statements and the recent series of large corporate failures has had serious and widespread repercussions on financial markets.

The FSF reviewed recent initiatives by market participants, national authorities and international standard-setters and organisations to restore market integrity and stability. Progress on these initiatives must be sustained – an area where the FSF can usefully provide encouragement. Given the international dimensions of the problems and their remedies, FSF members also underscored the importance of international and cross-sectoral consultations to ensure that these efforts are based on high level principles that are coherent across countries.¹

- **Corporate governance.** Poor corporate governance has played a central role in many of the recent failures. National authorities should act to improve practices in this area. Members welcome the decision by OECD Ministers to bring forward to 2004 their comprehensive review of international *Principles of Corporate Governance* and urge that, to the extent possible, the revised principles embody specific guidance.
- **International accounting standards.** Accounting treatment of consolidated entities, revenue recognition and equity-based remuneration has been a key issue in the current undermining of confidence. The FSF calls upon national and international standard setters to accelerate their efforts at developing more comparable, accurate and transparent ways of accounting for these in financial statements; to improve international accounting standards; and to bring about greater international convergence on principles-based standards.
- **Auditing standards and practices.** Independent and high quality auditing is of fundamental importance to the integrity of markets. The international community is consulting on the most effective practices in this area. The FSF took note of initiatives for auditor oversight in train in a number of jurisdictions. The FSF welcomes the principles on auditor independence and audit profession oversight that are being formulated by the International Organisation of Securities Commissions (IOSCO) and looks forward to their early approval and publication. It also urges the International Federation of Accountants to intensify its work on improving *International Standards of Auditing*.
- **Disclosure.** Material information must be disclosed in a comprehensive, truthful, timely and clear manner. The FSF noted recent and pending reforms in the United States and other member countries. Members look forward to the early approval and publication of principles on disclosure and transparency being developed by IOSCO.
- **Credit rating agencies.** The analysis provided by credit rating agencies has a pervasive influence on financial markets. The FSF noted work under way by the U.S. Securities and Exchange Commission to review the policies and procedures of credit rating agencies. The FSF will discuss the conclusions of that review at its next meeting.

The FSF will report to the G-7 Finance Ministers and Governors later in September, underscoring the importance of implementation of sound market practices based on the principles that have been agreed. It will continue to monitor initiatives and, in part through its outreach activities, promote and help to coordinate reform efforts by national authorities and international standard setters in all these areas. It will focus attention on issues of coherence and opportunities to increase the efficiency, integrity and stability of financial markets. At its next meeting in March 2003, it will review again progress made and issues outstanding.

Improving transparency in the reinsurance industry

The FSF reviewed a number of concerns related to the reinsurance industry. It noted that the reinsurance industry had performed well in the face of recent shocks. However, the opaqueness of the reinsurance market and of public disclosures makes it difficult, if problems in the reinsurance industry were to arise, to assess the potential impact on the insurance sector as a whole and on financial stability more generally. It was also pointed out that some of these issues are also relevant to other parts of the insurance industry.

Members call for efforts at the national and the international level to produce data and reporting on the global reinsurance market. At the same time individual reinsurance and insurance firms should expand the frequency and enhance the quantitative and qualitative content of their public disclosures. These efforts should begin speedily. The FSF lends its full support to the work of the IAIS and others to improve industry disclosures and to develop

an efficient global framework for reinsurance supervision, which could benefit reinsurers, primary insurers and policyholders, and therefore economies at large.

Offshore financial centres

The FSF re-emphasised the importance of progress by offshore financial centres (OFCs) in bringing their supervisory, regulatory, information sharing and cooperation practices up to international standards. The FSF welcomes the acceleration of the IMF's assessment program, and reiterates its expectation that all OFCs should have completed and published by 2003 assessments of their observance of international standards, along with action plans to address gaps.

In this context, members:

- welcome the recent publication by Aruba and Macau SAR of their IMF assessments (available at www.imf.org) and encourage those that have had assessments -- Andorra, Belize, Costa Rica, Lebanon, Marshall Islands, Monaco, Netherlands Antilles, Seychelles, Vanuatu -- to disclose the results when the assessment process is completed and to act speedily to implement its recommendations;²
- call on those that have requested assessments of observance of standards under the IMF's Module 2 or the FSAP -- Anguilla, Antigua and Barbuda, Bahrain, Barbados, The Bahamas, Bermuda, British Virgin Islands, Cayman Islands, Cook Islands, Guernsey, Isle of Man, Jersey, Liechtenstein, Labuan (Malaysia), Malta, Mauritius, Samoa, St Kitts and Nevis, St Lucia, St Vincent and the Grenadines, The Turks and Caicos -- to disclose publicly the results of these assessments when they have been completed, along with action plans to implement recommendations; and
- regret that some OFCs -- Nauru, Niue -- have not yet requested an IMF Module 2 assessment.

The FSF recognised that resource limitations can be a constraint in the implementation of standards and calls upon its members to strengthen the provision of technical assistance to promote further progress by OFCs.

The FSF will assess the overall effectiveness of its OFC initiative in 2003.

The FSF also:

- reviewed options for improving information on highly leveraged institutions and noted that the Joint Forum is pursuing work in this area;
- discussed lessons that have been drawn for contingency arrangements in the context of 11 September; and
- took note of national arrangements for information exchange to combat terrorist financing, and of progress made by FATF, the IMF and the World Bank to develop assessments of observance of standards for anti-money laundering and combating of terrorist financing.

The next meeting of the FSF will be held in Berlin on 24/25 March 2003.

Notes

- 1 In 2001, the FSF highlighted 12 widely agreed standards that underlie well functioning and stable financial markets. These standards cover broad areas such as macro-economic policy, market foundations and financial regulation and supervision. Four of these 12 essential standards - concerning corporate governance, accounting, auditing and securities regulation - are central to current reform efforts to increase investor confidence in equity markets: (see <http://www.fsforum.org/standards>).
- 2 Dublin (Ireland) participated in the pilot phase of the FSAP. Assessments conducted during the pilot phase cannot be published under IMF and World Bank policy.

For further information on the FSF, its membership and its activities, visit the FSF web site at www.fsforum.org.

**Institutions and Groups Attending the Meeting of the FSF
3-4 September 2002**

Chairman

Mr Andrew D Crockett

National Authorities (26)

Australia

Reserve Bank of Australia

Canada

Department of Finance

Bank of Canada

Office of the Superintendent of Financial Institutions

France

Ministry of the Economy

Commission des Operations de Bourse

Banque de France

Germany

Ministry of Finance

Bundesanstalt für Finanzdienstleistungsaufs

Deutsche Bundesbank

Hong Kong SAR

Hong Kong Monetary Authority

Italy

Ministry of the Economy and Finance

Banca d'Italia

CONSOB

Japan

Ministry of Finance

Financial Services Agency

Bank of Japan

Netherlands

De Nederlandsche Bank

Singapore

Monetary Authority of Singapore

United Kingdom

Bank of England

Financial Services Authority

H M Treasury

United States

Department of the Treasury

Securities & Exchange Commissior

Board of Governors of the Federal

Reserve System

National Association of Insurance c

Commissioners

International Financial Institutions (6)

International Monetary Fund (IMF), 2

World Bank, 2

Bank for International Settlements (BIS)

Organisation for Economic Co-operation
and Development (OECD)

**International Regulatory and
Supervisory Groupings (7)**

Basel Committee on Banking Supervision
(BCBS), 2

International Accounting Standards Board
(IASB)

International Association of Insurance
Supervisors (IAIS), 2

International Organisation of Securities
Commissions (IOSCO), 2

**Committees of Central Bank
Experts (2)**

Committee on Payment and
Settlement System (CPSS)

Committee on the Global
Financial System (CGFS)

European Central Bank