

Press release

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Financial Stability Forum holds its eleventh meeting

The Financial Stability Forum (FSF), chaired by Roger W. Ferguson, Jr., Vice Chairman of the Board of Governors of the Federal Reserve, met on 29-30 March in Rome. The discussion focused on three topics: vulnerabilities in the international financial system; offshore financial centres; and market foundations and corporate governance.

Vulnerabilities in the international financial system

Members observed that the global upswing in recent months is on a relatively secure footing, supported by factors such as accommodative policies, favourable financing conditions and rising corporate profits. Balance sheets in financial corporations have generally improved. Members discussed issues relating to the eventual transition to more neutral interest rates, supply and demand dynamics for certain commodities and asset valuations associated with the accelerating global upturn. International imbalances persist and may pose risks.

Members discussed the risks and policy implications that high levels of household indebtedness in many countries could pose to financial systems. Although household indebtedness was thought unlikely to pose a significant direct risk to financial intermediaries or growth, the Forum shared the view that it would likely increase the sensitivity of consumer spending to interest rates in certain economies and could exacerbate an economic downturn in the event of an unexpected deterioration of economic fundamentals.

Members observed that fundamentals of most emerging market economies (EMEs) have improved and that the rise in capital flows to EMEs has been associated with a sharp compression of risk premia on EME debt. In this connection the Forum discussed whether the recent spread compression has been well justified by the improvements in domestic fundamentals of EMEs. Some concerns were expressed about a possible widening of spreads and reversal of capital flows in the event of a shift in policies in major economies or a sudden shock affecting investor confidence.

Reinsurance. Members discussed a report from the IAIS Task Force on Enhancing Transparency and Disclosure in the Reinsurance Sector. They commended the Task Force on its efforts and welcomed the framework it has developed for collecting, processing and publishing global reinsurance market statistics covering a significant proportion of the reinsurance activity worldwide. The statistics will make a substantial contribution to enhancing transparency in the reinsurance sector. The Forum looks forward to seeing the first global reinsurance market report, analysing 2003 data, later this year. However, more needs to be done to enhance understanding in this complex area. In that regard, members welcomed the establishment of the IAIS Steering Group on Transparency in the Reinsurance Sector to carry the work forward. They encourage reinsurance firms to improve the public disclosure of their risk exposures and of the financial resources available to absorb those risks.

Credit risk transfer (CRT). Further to the FSF's request last September, members reviewed interim results of the study provided by the Joint Forum with involvement of principal participants in CRT markets. The study covers recent market developments, the understanding of market participants of the risks involved, the possibility of undue concentrations of credit risk,

and risk management practices employed. Members expressed appreciation for this work, emphasising its importance, and look forward to continued efforts, including recommendations. They took note of ongoing work on CRT issues in other fora.

Offshore Financial Centres (OFCs)

The FSF has taken a close interest in the progress made by offshore financial centres (OFCs) in strengthening their regulatory, supervisory, cooperation and information exchange arrangements. In May 2000, the FSF encouraged OFCs to undertake needed reforms and asked the IMF to put in place an assessment program that would ensure progress on a lasting basis. Taking notice of the 7 February statement of G7 Finance Ministers and Central Bank Governors, the FSF will continue to take a close interest in this matter. The FSF will issue a separate press release on its discussion with respect to OFCs in several days.

Market foundations and corporate governance

The Forum discussed issues raised by recent high profile incidents of securities fraud and market abuses, including the Parmalat case, and reviewed progress in work to strengthen the financial reporting framework and market foundations more generally.

Issues highlighted by recent incidents. Members noted that recent corporate incidents, especially the Parmalat case, have highlighted the importance of implementing recent measures to strengthen corporate governance and financial reporting frameworks. But they have also illuminated other issues, including the need to review implementation of existing standards on information exchange and cooperation, the role of unregulated entities and complex group structures, the adequacy of risk management of large commercial and investment banks involved and the corresponding regulatory challenges. The FSF welcomed the creation by IOSCO's Technical Committee of a special Chairmen's Task Force to look into many of these issues.

Credit rating agencies. Members reviewed issues relating to the operation of credit rating agencies (CRAs). Members discussed the US SEC's follow-up to its Concept Release on CRAs that was issued last June. Members also welcomed the forthcoming discussion at a special Task Force set up by IOSCO's Technical Committee to develop a code of conduct for CRAs, with a particular focus on conflicts of interest in the ratings process.

Audit quality and auditor oversight. Members welcomed IFAC's adoption of reforms on audit-related standard setting activities, including the proposal to create a Public Interest Oversight Board (PIOB). In this regard, the Forum urged that the PIOB be established and its members selected as soon as possible. The FSF looked forward to the results of the survey on national auditor oversight arrangements that is to be carried out by IOSCO in cooperation with the Monitoring Group involved with IFAC's governance reform.

Accounting standards. Members welcomed the IASB's completion of improvements to existing standards, the progress in the convergence project with the FASB and the work of all parties to finalise IAS 39. The FSF took note of the need for further work on outstanding issues, taking into account financial stability considerations. Attention should be given to implementation of IAS standards by 2005 and to improvements to the IASB's consultative processes.

Corporate governance. The FSF welcomed progress on the OECD's work on the revised Corporate Governance Principles.

The next meeting of the Financial Stability Forum will be held in Washington D.C. on 8-9 September 2004.

Attachment.

**Institutions and Groups Attending the Meeting of the FSF
29-30 March 2004**

**Chairman
Mr Roger W. Ferguson, Jr.**

National Authorities (25)

Australia

Reserve Bank of Australia

Canada

Department of Finance

Bank of Canada

Office of the Superintendent of Financial Institutions

France

Ministry of Economy, Finance & Industry

Banque de France

Autorité des Marchés Financiers

Germany

Ministry of Finance

Deutsche Bundesbank

BaFin

Hong Kong (SAR)

Hong Kong Monetary Authority

Italy

Ministry of the Economy and Finance

Banca d'Italia

CONSOB

Japan

Ministry of Finance

Bank of Japan

Financial Services Agency

Netherlands

De Nederlandsche Bank

Singapore

Monetary Authority of Singapore

United Kingdom

H M Treasury

Bank of England

Financial Services Authority

United States

Department of the Treasury

Board of Governors of the Federal Reserve System

Securities and Exchange Commission

International Financial Institutions (5)

International Monetary Fund (IMF), 2

World Bank

Bank for International Settlements (BIS)

Organisation for Economic Co-operation and Development (OECD)

Committees of Central Bank Experts (2)

Committee on Payment and Settlement System (CPSS)

Committee on the Global Financial System (CGFS)

International Regulatory and Supervisory Groupings (8)

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

The Joint Forum

European Central Bank (1)