

Press release

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Progress made in addressing concerns raised by Highly Leveraged Institutions

The Financial Stability Forum (FSF) published today a report by Howard Davies, Chairman of the UK FSA and Chairman of an earlier FSF Working Group, on progress in implementing recommendations endorsed by the FSF last year to address concerns about Highly Leveraged Institutions (HLIs). The recommendations addressed the systemic risks raised by the near collapse of Long-Term Capital Management in the autumn of 1998, and the concerns triggered by the operations of HLIs in the financial markets of emerging market economies.

The progress report was discussed at a meeting of the FSF earlier this year. It draws on work carried out by various supervisory and private sector groupings, including a joint task force of the Basel Committee on Banking Supervision and IOSCO, a multidisciplinary working group on public disclosure sponsored by four international financial services regulatory organisations, a group of major market participants in the foreign exchange markets, and the Global Documentation Steering Committee.

The report notes that good progress is being made to strengthen **counterparty risk management and regulatory oversight**, notably with regard to senior management reporting of HLI exposures, general standards of credit analysis, due diligence and documentation.¹ However, credit providers need to make further progress in the measurement of credit exposures, including the conduct of comprehensive stress tests. Supervisors remain concerned about the ability of regulated firms to resist market pressures, in particular on initial margin.

Disclosure of information by HLIs to credit providers has improved in terms of both quality and quantity. But progress remains inconsistent, with confidentiality concerns and competitive pressures sometimes limiting information flows. The report notes that a comprehensive voluntary study involving key financial institutions and hedge funds in setting out a basis for improvements in public disclosure of financial risks has been completed.² Progress towards introducing mandatory public disclosure requirements for HLIs/hedge funds has been limited, however.

Leading foreign exchange market participants have agreed a set of **Good Practice Guidelines for Foreign Exchange Trading** to help address concerns that large and concentrated HLI positions could have the potential to influence materially market dynamics in small and medium-sized open economies.³ The guidelines have been endorsed by the bodies responsible for foreign exchange market standards in the main financial centres and will be incorporated into existing codes of market conduct.

¹ For further details, see *Review of Issues Relating to HLI Activities*, published on 22 March 2001. The report is available on www.bis.org and www.iosco.org.

² See *Report of the Multidisciplinary Working Group on Enhanced Public Disclosure*, published on 26 April 2001. The report is available on www.bis.org, www.iosco.org, www.iaisweb.org, and www.fsforum.org.

³ See press release on *Trading Principles* issued in London, 22 February 2001. The press release is annexed to the report published today.

Progress is also being made in **addressing weaknesses in legal documentation** practices revealed by the market disturbances of 1998.⁴ But it has proved difficult to achieve improvements in the consistency, where appropriate, between different industry standards. The earlier HLI report noted that legal documentation underlying all financial contracts is a crucial building block in the stability of the financial system.

The progress report also draws on an analysis of recent developments in the hedge fund industry, based on an update by the IMF of an earlier study for the working group. This update is being released as an annex to the progress report.

When the FSF discussed the progress report at its earlier meeting this year, it confirmed its prior decision to review thoroughly all the recommendations of the Working Group in March 2002.

The report is available on the FSF website at <http://www.fsforum.org/Reports/RepHLIprog.pdf>

Note for editors

For related information, please see

- **Report of the Working Group on HLIs, April 2000**
(<http://www.fsforum.org/Reports/RepHLI.html>)
- **Press Communiqué after the Fifth Meeting of the Financial Stability Forum**
(<http://www.fsforum.org/Press/P20010323.html>)

The FSF was established in February 1999 to promote international financial stability through enhanced information exchange and international co-operation in financial market supervision and surveillance. It brings together on a regular basis national authorities responsible for financial stability in significant international financial centres, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts. The FSF is chaired by Andrew Crockett, General Manager of the Bank for International Settlements, in a personal capacity.

Further information on the FSF is available at www.fsforum.org.

⁴ This work is being carried forward under the auspices of the Global Documentation Steering Committee.