FINANCIAL STABILITY FORUM

Press Release

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Financial Stability Forum holds its sixth meeting

The Financial Stability Forum (FSF), chaired by Andrew Crockett, General Manager, Bank for International Settlements, held its sixth meeting on 6-7 September 2001 in London.

The FSF reviewed how key financial systems and markets are responding to the world economic slowdown. Members generally considered that most major markets and financial institutions, which had earlier built up strong financial positions, have absorbed well the financial strains associated with the slowdown. In addition, many of the efforts in recent years to strengthen the international financial system are helping to mitigate contagion effects. Nevertheless, the interaction of slower economic growth and possible financial vulnerabilities called for vigilance, especially if slow growth persists, as pressures tend to build over time. Members agreed that continued intense supervisory oversight and co-operation will be important.

The FSF reviewed the actions taken so far to address the concerns raised in the March 2000 FSF Report on ***Offshore Financial Centres (OFCs)***. There are signs of progress but more is required. FSF members re-iterated the importance of OFCs disclosing assessment results and their plans for addressing areas that need improvement. Such disclosures provide a useful means for OFCs to demonstrate their commitment to and progress towards meeting international standards, and help facilitate the timely provision of technical assistance.

The FSF encourages further efforts by OFCs to improve their supervisory and co-operation practices, including participation in the IMF assessment program, and will continue to monitor progress closely. FSF members encouraged the IMF to complete its assessment program as soon as possible. It called on its members to strengthen the provision of assistance to promote further progress by OFCs in implementing standards. The FSF also welcomed the proposal of the Basel Committee on Banking Supervision to set up a contact group with offshore supervisors. The FSF will review these issues in March 2002.

The FSF looked forward to the review scheduled for March 2002 that will consider how far the implementation of the FSF's March 2000 recommendations have been effective in addressing the concerns relating to ***Highly Leveraged Institutions***. It agreed that the background work, which should take into account changes in market circumstances, for undertaking this review should start promptly.

The FSF discussed progress in providing ***incentives to foster the implementation of standards***, drawing on a report of the Working Group, chaired by Axel Nawrath, Director-General, the Federal Finance Ministry of Germany.[1] While progress is being made, the FSF encouraged market practitioners to take further account of a jurisdiction's observance of standards in their investment and lending decisions. Technical assistance is needed to support implementation effectively and efficiently.

The FSF Working Group headed by Jean Pierre Sabourin, President of the Canada Deposit Insurance Corporation, which had been asked to develop guidance for the benefit

[1] The Executive Summary of the report is attached; the full report will be posted on the FSF web site shortly

of countries establishing or reforming a ***deposit insurance*** system, submitted its final report to the FSF.[1] The FSF welcomed the development of such guidance, noting that it had drawn on an extensive consultative process and would be adaptable to a broad range of country circumstances, settings and structures. FSF members considered that it would be particularly useful when moving from a situation where there may be an implicit or blanket guarantee to a system of explicit limited coverage.

The FSF welcomed the work of the Joint Forum in comparing approaches to risk management and capital regulation across the banking, insurance and securities sectors. FSF members highlighted a number of potential issues related to the increased use of mechanisms for risk transfer, including across financial sectors, and looked forward to the conclusions from the comprehensive work set in train by members to explore further the supervisory and systemic implications of these financial market innovations. It will return to these issues at the next meeting.

The FSF also:

- welcomed the work of the Joint Forum in comparing the three sets of Core Principles for effective banking and insurance supervision and securities regulation, which should help facilitate countries' implementing these Principles by clarifying their similarities and differences and ensuring a coherent framework, as appropriate.
- considered developments and issues in e-finance - notably the issue of financial related top level domains - drawing on a report of its Contact Group on E-Finance, headed by John D. Hawke, US Comptroller of the Currency.
- welcomed the work set in train by the Basel Committee on Banking Supervision and its Core Principles Liaison Group to develop guidance on dealing with weak banks. There is a strong demand for such guidance, not least from EMEs and IFIs.The guidance will aim to provide practical advice on identifying bank problems early and methods to deal with them. The FSF looked forward to the progress made in developing such guidance at its next meeting.
- discussed a range of other international financial issues, including those relating to accounting and provisioning for financial institutions, market dynamics, and large and complex financial institutions.

The next meeting of the FSF is scheduled to be held in Hong Kong SAR in March 2002.

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.

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

Institutions and Groups Attending the Meeting of the FSF
6/7 September 2001

Chairman

Mr Andrew D Crockett

National Authorities (25)

Australia

The Reserve Bank of Australia

Canada

Department of Finance
Bank of Canada
Office of the Superintendant of Financial Institutions

France

Ministry of the Economy
Commission Bancaire
Banque de France

Germany

Ministry of Finance
Bundesaufsichtsamt für das Kreditwesen
Deutsche Bundesbank

Hong Kong SAR

Hong Kong Monetary Authority

Italy

Ministry of the Treasury
Banca d'Italia
CONSOB

Japan

Ministry of Finance
Financial Supervisory Agency
The 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 Commission
Board of Governors of the Federal Reserve System

International Financial Institutions (6)

International Monetary Fund (2)
The World Bank (2)
Bank for International Settlements
Organisation for Economic Co-operation and Development

International Regulatory and Supervisory Groupings (6)

Basel Committee on Banking Supervision (2)
International Organisation of Securities Commissions (2)
International Association of Insurance Supervisors (2)

Committees of Central Bank Experts (2)

Committee on Payment and Settlement System
Committee on the Global Financial System

Attachment I

Report of the FSF Follow-Up Group on Incentives to Foster Implementation of Standards[2]

Executive Summary

This is a final report of the Follow-Up Group on Incentives to Foster Implementation of Standards (henceforth 'the Group'), set up by the Financial Stability Forum (FSF) in April 2000. The Group comprises representatives from industrial countries and emerging market economies (EMEs), standard setting bodies (SSBs) and international financial institutions (IFIs)[3]. In September 2000, the Group made a number of recommendations that aimed at enhancing market and official incentives for countries to implement international standards, in particular the 12 key standards highlighted by the FSF in March 2000.

On endorsing these recommendations, the FSF asked the Group to monitor progress in implementing them and to further raise market awareness of standards. For this purpose, the Group has conducted a number of surveys. A second survey of market practitioners, following the one in the spring of 2000, was conducted to assess changes, if any, in their awareness of standards and in the use of such information in risk assessments. The Group also conducted surveys of supervisors and regulators about the current practices governing market access decision-making and disclosure in sovereign bond prospectuses. Data on technical assistance (TA) provided by national authorities represented in the Group was gathered and analysed, too.

The Group is generally satisfied with the progress in the implementation of its recommendations. Those at the most advanced stage of implementation are in the area of raising market awareness through seminars and publications, and of enhancing external assessments on countries' compliance with standards in the form of ROSCs and FSAPs. The Group produced a booklet and a pamphlet aimed at raising awareness of standards: about ten thousand copies have so far been distributed to market practitioners and officials. The Group Members have also actively organised outreach exercises in their jurisdictions and/or internationally. More such events are planned for the future. Outreach exercises are now an integral part of the work of the IFIs and SSBs. The ROSC and FSAP exercises are now a regular features in the IMF and World Bank's activities. In addition, co-ordination between the IFIs and SSBs has been further strengthened.

The Group noted several analytical studies by official and private institutions as well as by academics, had looked at the link between the implementation of standards and the perceived credit risk. The IMF is planning to conduct further studies. The Group also noted that discussions are advancing, though still at an early stage, on how best to help countries formulate TA strategies following self- or external assessments, ant to translate these into specific projects supported by experts. As for incentives through supervisory methods, progress has been made in some areas (e.g., disclosure through sovereign bond prospectuses) and current practices in other areas are found to be generally in line with the Group's recommendations (e.g., market access decisions in banking). The revision of the Basel Capital Accord may also provide some element of incentives.

Against the background of general progress, the Group found that awareness and understanding of the key standards has increased among market practitioners. A number of practitioners say that they already take into account observance of international standards and codes into risk assessments and lending/investment decisions in one form or another, though the degree to which such information is used in risk decisions is

[2] The full report will be made available on the FSF web site (www.fsforum.org) by 11 September.

[3] See Annex I for the list of the Members.

uneven across institutions and across financial centres[4]. At the same time, senior management of many financial firms appears to agree that more could and should be done to reflect such information in lending/investment decisions. The Group thus thinks it important to engage more with senior management, especially in those financial centres where the new practice has yet to take root, so that increased awareness of standards will lead to a further increase in the use of such information in risk assessments.

In this connection, the Group has noted that familiarity with ROSCs has increased. Nevertheless, many market participants believe ROSCs' usefulness will be enhanced through an expansion of coverage, prioritisation of country selection, publication of results without exception, timely updates of the information and a streamlined, standardised format. The Group therefore welcomed the continued effort by the IFIs to ensure the user-friendliness of the ROSC format. The Group firmly supported, however, the IFIs' policy that ROSCs should not give the simple quantitative ratings, which some market participants appear to prefer.

Turning to the official sector, the Group noted that the lack of political will within governments and congresses of EMEs and developing countries has often created a hurdle for the further implementation of standards. For this purpose, the Group thinks it important to directly reach the business community within these countries. If the business community is made aware of the benefits of the implementation of standards, e.g. lower borrowing costs and a higher volume of foreign investment inflows, they might form a reform-minded constituency, which could induce governments and congresses to pursue further action.

At the same time, TA for capacity building in EMEs and developing countries will continue to play an important role. The Group thus believes that the international community should formulate a strategy, and a mechanism for information exchange, to meet the challenge of coping effectively with the expected increase in demand for TA for the implementation of standards.

[4] The Group's surveys show that institutions in New York are noticeably more advanced in their use of such information than in other major financial centres.

Report of the Working Group on Deposit Insurance [5]

GUIDANCE FOR DEVELOPING EFFECTIVE DEPOSIT INSURANCE SYSTEMS

Executive Summary

The Financial Stability Forum's Working Group on Deposit Insurance has developed guidance for the benefit of countries considering the adoption or the reform of an explicit, limited-coverage deposit insurance system (hereinafter referred to in this Report as "a deposit insurance system"). The guidance was developed through the preparation of a series of discussion papers and a consultative process that involved over 100 countries. In developing this guidance, the Working Group drew heavily on the practical experience of its members and other countries. Thus, the guidance is reflective of, and designed to be adaptable to, a broad range of country circumstances, settings and structures.

The principal objectives of a deposit insurance system are to contribute to the stability of a country's financial system and to protect less-financially-sophisticated depositors from the loss of their deposits when banks fail. There are a variety of options available for achieving these objectives.

A deposit insurance system is preferable to implicit protection if it clarifies the authorities' obligations to depositors and limits the scope for discretionary decisions that may result in arbitrary actions. To be credible, however, and to avoid distortions that may result in moral hazard, such a system needs to be properly designed, well implemented and understood by the public. A deposit insurance system needs to be part of a well-designed financial safety net, supported by strong prudential regulation and supervision, effective laws that are enforced, and sound accounting and disclosure regimes.

The first step in adopting a deposit insurance system or reforming an existing system is to specify appropriate public-policy objectives and to ensure that their implications are fully understood. In conjunction with identifying public-policy objectives, policymakers will need to assess a large variety of conditions and factors that can have a bearing on the design of the system. This self-assessment process is referred to in this Report as a situational analysis. Conditions and factors that should be taken into consideration include: the state of the economy, current monetary and fiscal policies, the state and structure of the banking system, public attitudes and expectations, the strength of prudential regulation and supervision, the legal framework, and the soundness of accounting and disclosure regimes. In many cases, country conditions may not be ideal and, therefore, it is important to identify gaps between existing conditions and more-desirable situations and thoroughly evaluate available options, since the establishment of a deposit insurance system is not a remedy for dealing with major deficiencies.

Countries transitioning from a blanket guarantee to a deposit insurance system should undertake the same type of situational analysis as countries moving from implicit protection. The transition from a blanket guarantee should be as rapid as the country's circumstances permit, since adjustment can become more difficult the longer it is in place. Public awareness plays a particularly important role in enabling a smooth transition.

After the self-assessment process has been completed, policymakers should turn their attention to specific deposit insurance system design features. The starting point should be to address the mandates, powers and basic organisational structure of the deposit insurer. Although no single set of mandates, powers and structures is suitable in all circumstances, those elements should be well defined, understood, and consistent with public-policy objectives, and there should be clear oversight and accountability for the

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system. It also is critical to address explicitly interrelationship issues among safety-net participants by specifying clear mandates, effective information exchange, confidentiality of information, and close coordination of the activities relevant to the deposit insurer.

Policymakers then should consider membership and coverage issues. Explicit eligibility rules should exist and be transparent, and membership generally should be compulsory. When deciding on the scope and level of coverage, policymakers should consider the relative importance of different deposit instruments in relation to stated public-policy objectives and the effect that the level of coverage may have on moral hazard. The level of coverage can then be set through an examination of relevant data from banks.

Deposit insurance systems need to have access to adequate funds in order to reimburse depositors promptly. The characteristics of the system and its benefits and limitations should be publicised regularly so that its credibility can be maintained and strengthened.

There are a variety of methods available to safety-net participants for resolving failed banks or to deal with banks that are in danger of failing. The methods are: liquidation and reimbursement of depositors' claims, purchase-and-assumption transactions and open-bank financial assistance. Asset-management and disposition strategies should be guided by commercial considerations and their economic merits.

Finally, the Working Group recommends that a continuous-improvement process be instituted for reviewing the extent to which a deposit insurance system is meeting its objectives. In this way, a country can ensure that its deposit insurance system remains consistent with economic and social conditions and lessons learned, and is better able to deal with evolving challenges.