Financial Stability Forum holds its thirteenth meeting in Tokyo

The Financial Stability Forum (FSF), chaired by Roger W. Ferguson, Jr., Vice Chairman of the Board of Governors of the Federal Reserve, met on 11 March in Tokyo. Members discussed risks and vulnerabilities in the international financial system and reviewed ongoing work to mitigate sources of vulnerability. In a separate meeting, Forum members discussed with senior financial officials from the People’s Republic of China recent developments in the Chinese economy and financial system and other financial sector issues in Asia.

Vulnerabilities in the international financial system

Members noted that the near-term outlook for global growth and inflation and the current balance sheet strength of financial institutions provided a positive backdrop for financial stability. However, members identified risks with the potential to cause strains in financial systems. These included the current level of global funding and market liquidity and the associated low levels of risk premia and long-term interest rates. Other potential risks discussed included the process of unwinding global current account imbalances, the continued tightness of commodity markets and possible spillovers to other economies from future capital account or economic developments in China.

Members observed that levels of spreads and long-term interest rates can partly be explained by the benign current conjuncture, but some expressed a view that market participants may be underpricing risks. Members noted that market participants need to closely monitor and manage evolving risks, including through stress-testing of exposures to more adverse scenarios.

Risk transfer to the household sector

Members also discussed longer-term issues relating to financial risks faced by households and the corresponding policy implications. Major changes in financial tools and risk exposures are underway on both the asset and liability sides of household balance sheets. Analysis of the implications of these developments for financial stability is still at an early stage. Members observed that these changes allow households either to avoid or take on greater financial risk, by taking advantage of the greater range of financial products available. Members highlighted the need to foster greater financial education for households.

Ongoing work to mitigate sources of vulnerability

Accounting and auditing issues. Members welcomed the recent establishment of the Public Interest Oversight Board (PIOB) to oversee the activities of the International Federation of Accountants’ international standard-setting relating to auditing and member body compliance programmes. There is a strong public policy interest in sound international audit practice standards and their effective implementation. The FSF, which had urged the establishment of the PIOB, will continue to support its activities. Members also noted progress towards international convergence in accounting standards and encouraged a positive outcome with regard to the finalisation of IAS 39 and other important conceptual accounting issues.
Hedge funds. Members discussed the continued rapid growth of the hedge fund sector and the systemic importance of hedge funds’ counterparty relationships. The FSF will continue to review developments with respect to hedge funds at subsequent meetings.

Reinsurance. Members noted the publication of the first global reinsurance market report by the IAIS in December 2004 and discussed the IAIS’s approach to future work to develop data collection and analysis of the sector. They were also briefed on the work of a study group set up by the Group of Thirty to examine the role of reinsurance in global capital markets.

Business continuity and liquidity risk management of financial institutions. Members welcomed the progress being made by the Joint Forum in its work (i) to develop a set of high-level business continuity principles for financial authorities and financial industry participants and (ii) to review the liquidity risk management practices of financial institutions, especially large firms in times of stress.

Ways to overcome fraud in financial markets. Members discussed the findings and recommendations of a report by an IOSCO Chairmen’s Task Force on IOSCO’s response to recent high-profile incidents of securities fraud and market abuse. The report stressed the need to devote resources to implementation of existing best practices and also identified a few areas in which development of new best practice principles may be warranted. In a related discussion, the FSF agreed to review, at its next meeting, progress with respect to implementation of standards and codes more generally.

International remittances. Members reviewed work initiated recently by the CPSS and the World Bank on international remittance systems, which will map and compare the remittance markets in different countries and will identify general principles for international money transfers.

Principles of corporate governance. Following the successful revision of the OECD Principles, the FSF welcomes the work of the OECD Steering Group on Corporate Governance to develop an associated methodology that can be used for ROSC assessments. The FSF will receive an interim report on this work from the OECD at its fall meeting 2005.

Offshore financial centres
A separate press release is being issued today to announce a new process to promote further improvements in offshore financial centres (OFCs). The process is intended to continue to ensure that OFCs meet international standards as financial markets evolve and to address remaining problems in several OFCs, notably in the areas of effective cross-border cooperation, information exchange and adequacy of supervisory resources.

The next meeting of the Financial Stability Forum will be held in September 2005.

Attachment.
Institutions and Groups Attending the Meeting of the FSF
11 March 2005

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**
Banque de France
Ministry of the Economy
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 (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 (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

Committees of Central Bank Experts (2)

Committee on Payment and Settlement Systems (CPSS)
Committee on the Global Financial System (CGFS)

European Central Bank (1)