

Statement by Andrew Crockett
Chairman of the Financial Stability Forum
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Since its last report to the IMFC on 20 April 2002, the Financial Stability Forum (FSF) has focused on three priority areas: the evolution of economic and financial **vulnerabilities** affecting the world economy, concerns about risks in the **reinsurance** sector and national and international initiatives to **strengthen market foundations** in the wake of recent corporate failures.

Vulnerabilities in the international financial system

At its recent meeting in Toronto on 3-4 September, the FSF thoroughly reviewed risks and vulnerabilities affecting the international financial system. The Forum noted that the central macro-economic scenario remains one of a recovery that gradually gathers pace in major industrial economies. And while problems have continued to accumulate for the global financial system, financial markets have on the whole continued to function and to support economic activity. The experience of the financial sector overall supports the benefits of the considerable investments that have been made in risk management systems and in strengthening capital cushions in recent years.

At the same time, downside risks are now substantially greater than they were six months ago. Uncertainty remains high and intensified risk aversion could cause a retrenchment from credit markets and risk-taking more generally. Losses sustained in domestic and international activities are causing financial institutions and institutional investors to reduce exposures to emerging market economies perceived to face debt sustainability and currency mismatch problems. The insurance sector is a focus of increased concern in the light of recent financial market weakness and negative margin problems. Globally, financial systems have less capacity to absorb future shocks and there are now more weak links in the chain.

Against this background, the Forum emphasised that vigilance and close co-operation among financial authorities will be needed in the period ahead. Should significant downside risks materialise or risk aversion greatly intensify, financial authorities may need to act, as appropriate, to contain market deterioration. However, policy responses should not prevent the necessary shedding of excess capacity built up in previous years.

Addressing Weaknesses in Market Foundations

The FSF has reviewed the many initiatives underway in this area by market participants, national authorities and international standard-setters and welcomed the speed and determination with which the weaknesses are being addressed. The Forum emphasised the importance of seizing the current window of opportunity to pursue reforms to sustain and lock-in market-driven self-correction. Given the international dimension of the problems and their remedies, FSF members also underscored the importance of international and cross-sectoral coherence in reforms.

The FSF noted that poor **corporate governance** had played a central role in many of the recent failures, and called upon national authorities to act to improve practices in this area.

Members welcomed the decision by OECD Ministers to bring forward to 2004 their comprehensive review of international *Principles of Corporate Governance* and urged that, to the extent possible, the revised principles embody more specific guidance than previously.

Weaknesses in the **accounting treatment** of consolidated entities, revenue recognition and equity-based remuneration have also been a key issue in the current undermining of confidence. The FSF called upon national standard setters and the International Accounting Standards Board to accelerate their work to develop 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.

The Forum stressed that **auditing standards and practices** need improvement. Independent and high quality auditing is of fundamental importance to the integrity of markets. The FSF took note of initiatives for auditor oversight in train in a number of jurisdictions. The international community is consulting on the most effective practices in this area. In this regard, the FSF welcomed the principles on auditor independence and audit profession oversight that are being formulated by the International Organisation of Securities Commissions (IOSCO) and looked forward to their early approval and publication. It also urged the International Federation of Accountants (IFAC) to intensify its work to improve *International Standards of Auditing*.

Recent corporate reporting problems have also underscored the need for reforms to ensure that material information is disclosed in a comprehensive, truthful, timely and clear manner. The FSF welcomed recent and pending reforms in the United States and other member countries, and looked forward to the early approval and publication of **principles on disclosure** and transparency being developed by IOSCO.

The above work will result in revisions to some of the 12 key Standards and Codes that the FSF and IMF have identified as particularly important for strengthening financial systems. The ROSCs and FSAP programs of the IMF and the World Bank will be vital means of ensuring that these improvements are spread widely.

The FSF also discussed the role of **credit rating agencies**. In an environment of more marketable debt, the analysis provided by credit rating agencies has an increasingly pervasive influence on financial markets. The FSF welcomed the work under way by the U.S. Securities and Exchange Commission to review the policies and procedures of credit rating agencies and will discuss the conclusions of that review at its next meeting.

In the period ahead, the FSF will closely monitor the initiatives underway, focus attention on gaps and areas of important divergence in reform efforts and initiatives, and promote international and cross-sectoral coherence when these entail opportunities to increase the efficiency, integrity and stability of financial markets. It will also make use of its regional outreach initiatives to discuss evolving best practices and promote wider reforms. The FSF will review progress in reform efforts at its March 2003 meeting.

Improving Transparency in the Reinsurance Industry

The FSF has reviewed a number of concerns related to the reinsurance industry. The reinsurance industry plays an indispensable role in the provision of insurance coverage, and has become increasingly engaged in the underwriting and distribution of financial risk. While the reinsurance industry had performed well in the face of recent shocks, the opaqueness of the reinsurance market and of reinsurers' public disclosures makes it difficult to assess the

potential impact of problems in the industry, should they arise, on the insurance sector as a whole and on financial stability more generally. Some of these issues are also relevant to other parts of the insurance industry.

The FSF has therefore encouraged the regulators in the key jurisdictions in which large parts of the global industry is based to lead efforts nationally and within the International Association of Insurance Supervisors (IAIS) to produce data and reporting on the global reinsurance market. The Forum also called for improvements in the frequency and quantitative and qualitative content of public disclosures by individual reinsurers and insurance companies. These efforts should begin speedily. The FSF lent its full support to the work of the IAIS and national supervisors 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

At its recent meeting, the FSF also re-emphasised the need for continued efforts by many offshore financial centres (OFCs) to bring their supervisory, regulatory, information sharing and cooperation practices up to international standards. The FSF welcomed the acceleration of the IMF's assessment program, and noted that all OFCs should now be able to complete and publish by 2003 assessments of their observance of international standards, along with action plans to address gaps. The FSF welcomed the recent publication by Aruba and Macau SAR of their IMF assessments (available at www.imf.org) and encouraged others that have had assessments¹ to disclose the results and action plans when the assessment process is completed and to act speedily to implement recommendations.

The FSF also encouraged the jurisdictions² that have requested assessments of observance of standards under the IMF's Module 2 or the FSAP to disclose publicly the results of these assessments when they have been completed, along with action plans to implement recommendations; and regretted that some OFCs -- Nauru, Niue -- had not yet requested an IMF Module 2 assessment.

The FSF noted that resource limitations can be a constraint in the implementation of standards and called 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.

¹ Andorra, Belize, Costa Rica, Lebanon, Marshall Islands, Monaco, Netherlands Antilles, Seychelles, Vanuatu

² 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.