Statement by Roger W. Ferguson, Jr.

Chairman of the Financial Stability Forum

International Monetary and Financial Committee Meeting

24 April 2004

Washington, D.C.

The Financial Stability Forum (FSF) held its eleventh meeting on 29-30 March in Rome and focused on five topics: potential vulnerabilities in the international financial system; offshore financial centres; reinsurance; credit risk transfer; and market foundations and corporate governance.

Vulnerabilities in the international financial system

Members shared the view that cautious optimism about global recovery is justified, with real and financial factors being mutually reinforcing. In financial systems, previous strains have largely eased and corporate credit quality is improving. The financial sector is on the whole well placed to support recovery.

Nonetheless, and consistent with the Forum's mandate, members reviewed potential vulnerabilities affecting the international financial system. In this regard, members discussed the persistence of global imbalances and the lack of exchange rate flexibility in some economies, supply and demand dynamics for certain commodities, asset valuations associated with the accelerating global upturn, and the financial stability implications of the eventual transition to more neutral policy stances.

Members also 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, 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 the 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.

Offshore Financial Centers (OFCs)

The FSF has taken a close interest in OFCs since May 2000, when it encouraged these jurisdictions to undertake needed reforms and asked the IMF to put in place an assessment program that would ensure progress on a lasting basis. At the time of writing, virtually all of the 42 OFC jurisdictions considered by the Forum have been assessed by the IMF. Moreover, virtually all of the assessed OFCs have either published their IMF assessment reports or have confirmed their intention to do so when these reports are finalized. These decisions to publish have been strongly encouraged and welcomed by the Forum as a means of enabling the position of individual OFC jurisdictions to be evaluated on an objective basis by all concerned parties.

While it is difficult to generalize, the available assessments show that significant reforms have been initiated. In general, wealthier OFC jurisdictions have a much higher rate of compliance with the assessed international standards compared with jurisdictions with lower levels of income. However, shortcomings in the independence of the regulator, the level and quality of technical supervisory skills, and onsite and offsite inspections are recurrent concerns. In addition, resources of regulators and supervisors are insufficient if compared with the work load required by effective prudential activity and co-operation. The momentum for reforms therefore needs to be sustained.

The Forum attaches particular importance to OFCs improving cross-border co-operation and information exchange practices. As a general principle, international co-operation should aim at pre-emptively addressing matters of common concern before vulnerabilities and risks materialise. The Forum has therefore encouraged stepped up efforts among the IMF, international regulatory standard setters and onshore and offshore authorities to review and strengthen international standards in these areas, and the IMF to place greater emphasis on these issues in its future risk-focused OFC assessments.

Forum members will continue to take a close interest in OFCs. Specifically, they envisage continuing to work with the IMF and others, notably IOSCO, to encourage particular OFC jurisdictions to address prudential shortcomings and improve cooperation and exchange of information practices, relying on the full range of assessment options. This may include direct engagements with individual OFCs, as needed, in order to improve OFCs' compliance with international standards and practices, including in the corporate sector.

Reinsurance

The lack of transparency in the global reinsurance sector has been a concern for financial authorities some time. At the Rome meeting, Forum members welcomed a report detailing a framework for collecting, processing and publishing global reinsurance market statistics covering a significant sample of the reinsurance activity worldwide prepared by the International Association of Insurance Supervisors (IAIS). Members noted that these statistics, the first release of which is expected later this year, will make a substantial contribution to enhancing transparency in the reinsurance sector, provided that all jurisdictions in which key reinsurance firms are based submit data on a regular basis.

However, the Forum considered that the global reinsurance data are but a first step and that more needs to be done to enhance transparency and understanding in the complex area of reinsurance, including through the use of national data to augment global data, and to strengthen market discipline through improved public disclosures. Members therefore welcomed the establishment of an IAIS Steering Group to take forward work on these and related issues. The Forum also encouraged the reinsurance industry to support the Steering Group and to improve public disclosures of risk exposures and the financial resources available to absorb these risks.

Credit risk transfer (CRT)

Forum members reviewed an interim report by the Joint Forum (comprising representatives of the Basel Committee on Banking Supervision, the International Organisation of Securities Commissions (IOSCO), and the IAIS) investigating the remaining prudential and financial stability implications of CRT activity, including the question of whether the credit risk that banks have been shedding via credit risk transfer instruments was leading to undesirable concentrations of credit risk elsewhere in the system. Forum members took comfort from the Joint Forum's preliminary findings and emphasized the benefits of CRT in terms of risk distribution and price discovery. However, members also noted that some of the characteristics of the CRT market – opaque, fast growing and, to some extent, concentrated – have been associated with heightened risks in the past. The Joint Forum's final report, including recommendations, will be reviewed by the FSF at its September 2004 meeting.

Market foundations and corporate governance

Forum members have for some time taken a close interest in the progress and international coherence of work to strengthen the financial reporting framework and market foundations more generally. In Rome, the Forum was briefed on, and welcomed, the extensive work underway by an IOSCO Chairmen's Task Force to examine the novel issues raised by recent high profile incidents of securities fraud and market abuses, including the Parmalat case. Members considered the possibility that new such cases may emerge as strengthened regulatory and supervisory arrangements and improved market practices and scrutiny take hold.

The Forum also welcomed ongoing work by the US SEC and a newly established IOSCO Technical Committee Task Force to ensure the proper functioning of credit rating agencies, and the finalization of the OECD's work on its revised Corporate Governance Principles. Members looked forward to hearing on conclusions and any follow-up plans on these matters at their September meeting.

Finally, members underscored the importance of the November decision of the Governing Council of the International Federation of Accountants (IFAC) to approve, among other governance reforms, the establishment of a Public Interest Oversight Board (PIOB) to oversee IFAC's standard setting activities. Forum members emphasized the need to sustain momentum, and urged that the members of the PIOB be selected as soon as possible.

FSF Regional Meeting in Santiago de Chile, November 2003

As members of the IMFC are aware, the FSF holds regional meetings. In late November 2003, the Forum held its third regional meeting in Latin America, kindly hosted by the Central Bank of Chile. Senior representatives from finance ministries, central banks, and supervisory and regulatory authorities of the major regional economies plus Canada, Germany, Singapore, Spain, South Africa and the United States, as well as senior officials from international institutions and standard setting bodies, attended the meeting.

The meeting reviewed strengths and vulnerabilities in international and regional financial systems. Many economies in the region were expanding on the back of external demand and some recovery in domestic capital expenditure. Many economies had also been able to take advantage of the favourable external financing environment to strengthen debt profiles, and there was hope that the expected upswing could be used to further improve underlying fiscal positions. At the same time, some economies in the region face vulnerabilities, including potentially unsustainable public debt levels; currency mismatches in the corporate and financial sector; persistent weaknesses in the legal and regulatory environment; and declining international competitiveness. How to assess debt sustainability is an issue several countries struggle with. Participants felt that further illumination of this topic and opportunities to exchange experiences, would be welcome.

The meeting also discussed issues associated with financial market infrastructure and the environment affecting foreign direct investment in the financial sector. Reforms, including the enactment of laws, have been undertaken to develop markets, strengthen regulatory frameworks and shore up corporate governance. Enforcement is problematic, however, with weaknesses in the judicial system a major factor. There was general agreement that foreign direct investment in the financial sector had added stability and efficiency to local financial systems. However, some concern was expressed about uncertainties surrounding parent support for local subsidiaries in times of distress. It was agreed that a sound and predictable regulatory and legal environment, and dialogue, is needed to address these concerns.

The Forum's next regional meeting will take place in Beijing in late May 2004.